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UKRAINE

April 2017

2016 ARTICLE IV CONSULTATION AND THIRD REVIEW UNDER THE EXTENDED ARRANGEMENT, REQUESTS FOR A WAIVER OF NON-OBSERVANCE OF A PERFORMANCE CRITERION, WAIVER OF APPLICABILITY, REPHASING OF ACCESS AND FINANCING ASSURANCES REVIEW—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR UKRAINE

In the context of the 2016 Article IV Consultation and third review under the Extended Arrangement, Requests for a Waiver of Non-Observance of a Performance Criterion, Waiver of Applicability, Rephasing of Access and Financing Assurances Review, the following documents have been released and are included in this package:

- **Press Releases** including a statement by the Chair of the Executive Board and summarizing the views of the Executive Board as expressed during its April 3, 2017 consideration of the staff report on issues related to the Article IV consultation and the IMF arrangement.
- A **Staff Supplement** updating information on recent developments.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on April 3, 2017, following discussions that ended on November 16, 2016, with the officials of Ukraine on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on March 7, 2017.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Alternate 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*
Selected Issues
*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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IMF Executive Board Concludes 2016 Article IV Consultation with Ukraine

On April 3, 2017, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Ukraine and completed the third review of Ukraine's economic program under the Extended Fund Facility (see Press Release No. 17/111).

Following a severe crisis in 2014–15, the economy is growing again—by 2.3 percent in 2016—and the flexible exchange rate and tight fiscal and monetary policies have greatly reduced internal and external imbalances. The current account deficit fell sharply, from over 9 percent of GDP in 2013 to 3.6 percent of GDP in 2016 and reserves—while still low—have doubled to US$15 billion. The overall fiscal deficit—including the energy sector's quasi-fiscal losses—which had increased to 10 percent of GDP in 2014—declined to 2.3 percent of GDP in 2016, supported by strong spending control and the decision to raise energy tariffs to market levels. Inflation has fallen steadily from its peak of 61 percent in April 2015 to 12.4 percent by end-2016, well within the target range of the National Bank of Ukraine (NBU).

However, progress in advancing structural reforms has been mixed. While there have been important achievements in the energy and financial sectors, there was limited progress in reforming and privatizing state-owned enterprises, land and pension reforms, and effectively tackling corruption. Moreover, important economic challenges remain. In particular, public debt, projected to increase to close to 90 percent of GDP in 2017, remains high for an emerging market economy; international reserves, while having increased, are still low by any metric; the financial system remains heavily dollarized; non-performing loans have reached a record high; and the public sector is large and inefficient, while pressures to increase public spending loom strong.

In the coming years, the strength and durability of the recovery depend critically upon the pace and depth of structural reforms. Growth will remain at 2 percent in 2017 due to the impact of the blockade in the eastern part of Ukraine, but is expected to reach 3 percent in 2018 as the economy adjusts, and to around 3½–4 percent over the medium term, subject to a major acceleration in critical structural reforms to improve the business environment and attract

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

investment, increase productivity, and increase labor market participation. Inflation is expected to gradually decline to the NBU's medium-term target of 5 percent in the coming years, as one-off effects subside, monetary policy remains appropriately tight, and confidence strengthens. Reserve adequacy—as measured by the IMF composite index—is expected to be achieved by end-2018. Public debt is projected to drop below 70 percent of GDP by 2021, assuming the successful completion of the debt operation, the preservation of the fiscal consolidation achieved to date, and a gradual pickup of growth.

Executive Board Assessment[2]

Executive Directors commended the authorities' decisive policy actions in the past two years that have led to a return to growth, a sharp reduction in inflation, an increase in international reserves, and a reduction in imbalances amid a challenging environment. Directors recognized the authorities' efforts to tackle a number of long-standing weaknesses, including raising gas and heating tariffs, reigning in large budget deficits, cleaning up the banking system, and maintaining a flexible exchange rate. At the same time, some important structural reforms have lagged, while the challenges facing Ukraine remain daunting. Directors underscored the need to consolidate the progress thus far and make faster progress with critical reforms going forward. Directors were reassured by the authorities' commitment to address increased risks posed by recent developments in the country.

Directors stressed the need to accelerate reforms to improve the business environment and attract investment. They emphasized the need for more progress in privatization, the development of a land market, and the reform of the large state-owned enterprise sector. Directors welcomed the creation of new anticorruption institutions, but strongly urged the authorities to strengthen these institutions further and to establish an independent anticorruption court to achieve concrete results, in order to support the reform program, attract investment, and achieve faster growth. They noted that more rapid progress in these areas is crucial to achieving the program objectives and the stronger growth needed to lift incomes and allow Ukraine to catch up with its regional peers. An acceleration of structural reforms is all the more important in light of recent developments and the increased risks that they represent.

Directors welcomed the remarkable fiscal adjustment over the past couple of years. They emphasized that continued commitment to fiscal consolidation is needed to place the public debt ratio on a steady downward path. They highlighted the importance of structural fiscal reforms to secure medium-term sustainability. They urged the authorities to adopt without further delay a comprehensive pension reform, including to increase the effective retirement age, to address the pension fund's large deficits and create room for better pensions. They also emphasized the need

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

to contain the wage bill, improve revenue and public administration, and implement health and education reforms.

Directors welcomed the authorities' decision to nationalize Ukraine's largest bank to safeguard financial stability. They recommended pursuing all available means to ensure repayment of loans to minimize the cost to taxpayers. Directors underscored the importance of ensuring that all banks meet capital and regulatory requirements to maintain public confidence in the banking system and reinforce banks' ability to support growth. They also noted the need to address the high levels of nonperforming loans.

Directors agreed that the National Bank of Ukraine's (NBU) clear policy mandate and independence were key to the impressive progress in containing inflation and rebuilding international reserves in the context of a floating exchange rate regime. They underlined the importance of preserving the NBU's strong institutional framework. Directors agreed that further relaxation of monetary policy and administrative measures should be contingent upon continued progress in safeguarding financial stability and increasing reserves.

Directors welcomed the substantial international financial and technical support provided to Ukraine. They stressed the importance of continued efforts to reach an agreement on the restructuring of Ukraine's debt held by Russia in line with program parameters and the Fund's policy on lending into arrears to official bilateral creditors.

Ukraine: Selected Economic Indicators, 2014–18					
	2014	2015	2016	2017 Proj.	2018 Proj.
Real economy (percent change, unless otherwise indicated)					
Nominal GDP (billions of Ukrainian hryvnias)	1,587	1,989	2,383	2,734	3,074
Real GDP 1/	-6.6	-9.8	2.3	2.0	3.2
Contributions to real GDP growth					
Domestic demand	-13.3	-13.3	6.4	4.4	4.4
Net exports	6.7	3.5	-4.1	-2.4	-1.2
GDP deflator	15.9	38.9	17.1	12.5	9.0
Consumer prices (period average)	12.1	48.7	13.9	11.5	9.5
Nominal monthly wages (average)	6.1	21.1	23.3	28.0	12.0
Unemployment rate (ILO definition; percent)	9.3	9.1	8.8	9.0	8.7
Public finance (percent of GDP)					
General government balance 2/	-4.5	-1.2	-2.2	-3.0	-2.5
Overall balance (including Naftogaz balance)	-10.0	-2.2	-2.3	-3.0	-2.5
Public and publically-guaranteed debt	70.3	79.3	81.2	89.8	85.3
Money and credit (end of period, percent change)					
Broad money	5.3	3.9	10.9	10.8	19.2
Credit to nongovernment	12.4	-1.0	-1.1	7.8	8.4
Interbank o/n rate (annual average, percent)	12.2	21.5	16.9	...	...
Balance of payments (percent of GDP)					
Current account balance	-4.2	-0.3	-3.6	-3.7	-3.0
Foreign direct investment	0.2	3.3	3.6	1.7	2.5
Total external debt	95.4	130.0	123.8	127.4	126.3
Gross reserves (end of period, billions US$)	7.5	13.3	15.5	21.8	29.5
Months of next year's imports of goods and services	1.8	3.1	3.4	4.6	5.8
Percent of IMF composite metric (float)	25.1	51.4	61.9	82.0	102.4
Exchange Rate					
Hryvnia per U.S. dollar (end of period)	15.8	24.0	27.2	...	...
Real effective rate (deflator-based, percent change)	-20.9	-11.2	0.2	...	...

Sources: Ukrainian authorities 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.

Press Release No. 17/111
FOR IMMEDIATE RELEASE
April 3, 2017

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Concludes 2016 Article IV Consultation and Completes Third Review of Ukraine's EFF, Approving US$1.00 Billion Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the third review of Ukraine's economic program under the Extended Fund Facility (EFF). The completion of this review enables the disbursement of SDR 734.05 million (about US$1.00 billion), which would bring total disbursements under the arrangement to SDR 6,178.26 million (about US$8.38 billion).

The Executive Board today also concluded the 2016 Article IV consultation with Ukraine. A respective press release will be issued separately.

Ukraine's four-year SDR 12.348 billion (about US$17.5 billion at the time of approval of the arrangement) EFF was approved on March 11, 2015 (see Press Release No. 15/107) 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 is showing welcome signs of recovery. Growth is returning, inflation has been brought down, and international reserves have doubled. This progress owes much to the authorities' decisive policy actions, including sound macroeconomic policies. The recent stabilization provides a promising basis for further growth.

"To achieve faster, sustainable growth, needed to lift incomes and enable Ukraine to catch up with its regional peers, structural reforms to improve the business environment and attract investment need to be accelerated. A start needs to be made with privatization and developing a market for agricultural land. Corruption needs to be tackled decisively. Despite the creation of new anticorruption institutions, concrete results have yet to be achieved.

“Notwithstanding the large fiscal adjustment, public debt remains high. The urgency of structural fiscal reforms to ensure medium-term sustainability has increased, as pressures to raise wages and pensions are building. Ukraine cannot afford to delay comprehensive pension reform much longer, including by raising the effective retirement age. Sustained efforts are also needed to improve revenue administration and advance public administration reform.

“The National Bank of Ukraine (NBU) has skillfully managed monetary policy during a very challenging period. It will be important to safeguard the NBU’s independence and for monetary policy to remain focused on containing inflation and rebuilding international reserves within a flexible exchange rate regime. This will also make room for the gradual removal of remaining administrative measures.

“Impressive progress has been made in rehabilitating the banking system, but efforts need to continue to restore banks’ soundness and reinforce their ability to support growth. The recent nationalization of Ukraine’s largest bank was an important step to safeguard financial stability, but must now be followed by firm efforts to ensure repayment of loans to minimize the cost to taxpayers. The recapitalization of other banks and the unwinding of related-party exposures need to be completed.

“Ukraine’s international partners have provided substantial financial and technical support to the authorities’ efforts to strengthen the economy, and their continued assistance remains important for the success of the program. Good-faith efforts to resolve the remaining sovereign arrears must continue.”

UKRAINE

March 30, 2017

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION AND THIRD REVIEW UNDER THE EXTENDED ARRANGEMENT, REQUESTS FOR A WAIVER OF NON-OBSERVANCE OF A PERFORMANCE CRITERION, WAIVER OF APPLICABILITY, REPHASING OF ACCESS AND FINANCING ASSURANCES REVIEW—SUPPLEMENTARY INFORMATION AND SUPPLEMENTARY LETTER OF INTENT

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 was circulated to the Executive Board on March 7, 2017**. This information does not alter the thrust of the staff appraisal.

2. **On March 15, 2017, the authorities decided to suspend trade with the non-government controlled area (NGCA)**. Following the continuing tensions in the eastern region of Donbass, various war veteran and opposition groups blocked rail lines connecting the NGCA with the rest of Ukraine in late January–early February, contending that trade financially sustains the separatists and prolongs the conflict. The blockade also halted the transport of coal supplies from mines located in the NGCA, which are critical for metal factories (particularly steel) and power plants in Ukraine. Despite some efforts by the Ukrainian authorities to lift the blockade, the separatists moved to take control over all Ukrainian assets located in the NGCA including 40 medium- to large-sized companies. This triggered the decision by the authorities to ban the transport of all goods, excluding humanitarian aid, between the NGCA and the rest of Ukraine, until the property rights are restored.

3. **The increased tensions also affected parts of the financial system**. In the midst of these events, and following the recognition by Russia of identity cards issued by some districts in the Donetsk and Luhansk regions, physical attacks were launched in February and March by nationalist groups against a number of Russian state-owned banks operating in Ukraine. This caused damage to several branches and ATMs, and triggered sizable deposit outflows, raising liquidity pressures on these banks. The authorities imposed restrictions on the subsidiaries of Russian state-owned banks in the interest of national security, prohibiting financial transactions between these banks and their parent banks. The authorities notified the Executive Board of the measures under Decision No. 144-(52/51).

4. **These adverse events will have a sizable, although manageable impact on economic activity in the near term**.[1] The blockade was flagged as a key risk to the outlook in the recently issued staff report. However, while it was initially expected to be resolved relatively quickly, it is now expected to last longer and alter this year's economic outlook. In particular, the loss of recorded economic activity in the NGCA and the impact of the blockade on industrial production in the rest of Ukraine are expected to lower growth to 2 percent (from 2.9 percent previously) and widen the current account deficit, due to lower exports and higher import requirements (mainly coal and cokes), although this will be partly offset by a recent improvement in Ukraine's terms of trade.

5. **The authorities have reiterated their intention to take all necessary measures to safeguard economic and external stability**. This includes allowing the exchange rate to adjust and maintaining a tight monetary policy stance to limit the impact on the balance of payments and reduce inflation in line with the National Bank of Ukraine's (NBU) inflation objective. These actions will help limit the worsening in the current account deficit, which is projected to widen to 3¾ percent of GDP this year (from 3 percent previously). Nonetheless, while the NBU is still expected to continue to rebuild its reserve buffers, the pace will be somewhat slower than projected earlier this year. The NBU is committed to catch up with the program's reserve targets in the coming years, by maintaining appropriately tight monetary policies. The authorities also remain committed to the program's fiscal deficit targets. The loss in tax revenues from the companies' operations in the NGCA and reduced profitability of affected companies in the rest of Ukraine (estimated at about ¼ percent of GDP) will be offset by some expected revenue over-performance in other areas, while the authorities will maintain tight spending control.

6. **The authorities have also taken actions to safeguard the stability of the financial system**. This includes ensuring the safe and uninterrupted operation of the Russian state-owned banks in Ukraine—and banks' offices and branches that had been blocked have reopened—and adherence to the rule of law. In addition, as these banks, which account for about 8 percent of banking system assets, are solvent and in compliance with prudential

[1] The revised macro-economic framework also incorporates new GDP data for 2016, released by the statistical office on March 21, showing slightly stronger growth in 2016, both in real and nominal terms.

regulations, the authorities have assured that they have access to liquidity support, including emergency liquidity assistance from the NBU, if needed.

7. **The medium-term outlook is projected to remain broadly unchanged**. Growth is expected to pick up to 3.2 percent in 2018, albeit from a lower base and somewhat lower potential output, as the affected companies gradually adjust and increase production and investment outside the NGCA. The balance of payments and reserves are broadly expected to gradually revert back to the previously projected paths, although imports are likely to remain somewhat higher over the medium term.

Macroeconomic Framework

(Percent change, unless otherwise indicated)

	2016	2017		2018		2019	2020	2021
	Actual	3rd Review SR	Proj.	3rd Review SR	Proj.	Proj.	Proj.	Proj.
Real GDP	2.3	2.9	2.0	3.1	3.2	3.5	4.0	4.0
Inflation (eop)	12.4	10.0	10.0	7.0	7.0	6.0	5.0	5.0
General government balance 1/	-2.2	-3.1	-3.0	-2.6	-2.5	-2.3	-2.1	-2.0
Public Debt 1/	81.2	91.4	89.8	86.2	85.3	78.1	71.6	65.6
External current account 1/	-3.6	-3.0	-3.7	-2.6	-3.0	-2.4	-2.3	-2.9
GIR (eop, billions of U.S. dollars)	15.5	22.3	21.8	30.2	29.5	30.1	30.8	32.0
Months of next year's imports	3.4	4.7	4.6	5.9	5.8	5.4	5.2	5.0
Percent of IMF composite measures	61.9	83.9	82.0	105.3	102.4	101.3	101.8	102.4

Sources: Ukrainian authorities; and IMF staff estimates.

1/ Percent of GDP.

8. **The recent developments highlight the risks to the program, but also demonstrate the authorities' capacity to adapt and successfully implement the program**. In particular, the authorities have taken appropriate measures to safeguard the stability of the financial system and will adjust macro-economic policies as needed to cushion the impact of the recent developments on the balance of payments, the broader economy, and their ability to achieve the program's targets.

9. **On March 29, the UK High Court of Justice granted a summary judgement in favor of Russia regarding the US$3 billion Eurobond**. The court also granted a stay on execution of the judgement until the next hearing, which is expected to take place in late May, as well as Ukraine's request for right to appeal without any condition. The Ukrainian authorities have indicated their intention to appeal the decision and to request an extension of the stay through the appeal period. The court's decision does not alter staff's assessment that the requirements under the policy on lending into arrears to official bilateral creditors have been met. However, it remains important, as stressed in the staff report, that efforts continue to achieve a negotiated agreement in line with program parameters.

10. **In view of the authorities' actions, as outlined in the attached Supplementary Letter of Intent, and their commitments for the period ahead as outlined in their letter of March 2, 2017, staff recommends completion of the third review and the financing**

assurances review under the extended arrangement. With the postponement of the Executive Board consideration of the review, the end-March 2017 performance criteria have become controlling. Staff supports the authorities' request for a waiver of nonobservance of the end-March 2017 performance criterion on the NBU's net international reserves, which based on available information has not been observed due to the impact of the recent events, but also the impact from the nationalization of the country's largest bank on financial markets, based on the authorities' corrective actions, including allowing the exchange rate to adjust and maintaining tight monetary policies, as well as steps to safeguard the stability of the banking system. Staff also supports the authorities' request for a waiver of applicability of all the other end-March 2017 performance criteria, for which data are not yet available and for which there is no indication that they may have been missed.

11. It is proposed that the next Article IV consultation with Ukraine be held on the 24-month cycle, subject to the Decision on Article IV Consultation Cycles (Decision No. 14747 (10/96), as amended).

Table 1. Ukraine: Selected Economic and Social Indicators, 2016–21

	2016		2017		2018		2019	2020	2021
	3rd Review SR (Est.)	Actual	3rd Review SR	Proj.	3rd Review SR	Proj.	Proj.	Proj.	Proj.
Real economy (percent change, unless otherwise indicated)									
Nominal GDP (billions of Ukrainian hryvnias) 1/	2,280	2,383	2,626	2,734	2,953	3,074	3,421	3,773	4,162
Real GDP 1/	2.0	2.3	2.9	2.0	3.1	3.2	3.5	4.0	4.0
Contributions:									
Domestic demand	4.5	6.4	4.2	4.4	4.2	4.4	4.6	4.9	5.0
Private consumption	2.3	1.3	2.5	2.2	2.2	2.0	2.2	2.4	2.4
Public consumption	-0.3	0.0	-0.2	0.0	-0.1	-0.1	0.0	0.0	0.0
Investment	2.5	5.2	2.0	2.2	2.0	2.4	2.4	2.5	2.5
Net exports	-2.5	-4.1	-1.4	-2.4	-1.0	-1.2	-1.0	-0.9	-0.9
GDP deflator	13.0	17.1	12.0	12.5	9.0	9.0	7.5	6.0	6.0
Output gap (percent of potential GDP)	-3.4	-3.1	-1.7	-1.9	-0.9	-0.9	-0.6	-0.3	0.0
Unemployment rate (ILO definition; percent)	8.8	8.8	9.0	9.0	8.7	8.7	8.4	8.2	8.0
Consumer prices (period average)	13.9	13.9	11.5	11.5	9.5	9.5	6.5	5.5	5.0
Consumer prices (end of period)	12.4	12.4	10.0	10.0	7.0	7.0	6.0	5.0	5.0
Nominal monthly wages (average)	23.3	23.3	28.0	28.0	12.0	12.0	10.5	10.0	9.5
Real monthly wages (average)	8.2	8.2	14.8	14.8	2.3	2.3	3.8	4.3	4.2
Savings (percent of GDP)	14.5	17.9	16.5	18.0	19.5	21.8	24.2	25.2	25.3
Private	13.6	17.1	16.7	17.8	19.1	21.2	23.2	23.9	23.6
Public	0.9	0.8	-0.2	0.1	0.5	0.6	1.0	1.3	1.7
Investment (percent of GDP)	18.3	21.5	19.5	21.7	22.2	24.7	26.6	27.5	28.1
Private	15.1	18.5	16.6	18.9	19.1	21.8	23.5	24.3	24.7
Public	3.2	3.1	2.9	2.8	3.1	2.9	3.0	3.2	3.4
Public finance (percent of GDP)									
General government balance 2/	-2.3	-2.2	-3.1	-3.0	-2.6	-2.5	-2.3	-2.1	-2.0
Overall balance (including Naftogaz operational deficit)	-2.4	-2.3	-3.1	-3.0	-2.6	-2.5	-2.3	-2.1	-2.0
Public and publicly-guaranteed debt	84.9	81.2	91.4	89.8	86.2	85.3	78.1	71.6	65.6
Money and credit (end of period, percent change)									
Base money	13.6	13.6	13.6	13.0	13.0	12.7	12.0	11.7	11.3
Broad money	10.9	10.9	11.3	10.8	19.3	19.2	15.4	15.1	12.1
At program exchange rate	7.5	7.5	9.3	8.4	18.5	18.2	15.8	14.6	12.1
Credit to nongovernment	-1.1	-1.1	7.4	7.8	8.5	8.4	9.7	9.4	10.5
At program exchange rate	-3.7	-3.7	5.8	5.8	7.8	7.4	10.3	10.1	12.3
Velocity	1.8	1.8	2.1	2.2	2.0	2.1	2.0	1.9	1.9
Interbank overnight rate (annual average, percent)	16.9	16.9	...	...	...	...	...	...	...
Balance of payments (percent of GDP)									
Current account balance	-3.8	-3.6	-3.0	-3.7	-2.6	-3.0	-2.4	-2.3	-2.9
Foreign direct investment	3.8	3.6	1.7	1.7	2.5	2.5	3.3	3.6	3.4
Gross reserves (end of period, billions of U.S. dollars)	15.5	15.5	22.3	21.8	30.2	29.5	30.1	30.8	32.0
Months of next year's imports of goods and services	3.5	3.4	4.7	4.6	5.9	5.8	5.4	5.2	5.0
Percent of short-term debt (remaining maturity)	59.2	59.2	79.7	78.0	94.6	92.3	85.5	85.5	84.2
Percent of the IMF composite metric (float)	62.2	61.9	83.9	82.0	105.3	102.4	101.3	101.8	102.4
Goods exports (annual volume change in percent)	-3.4	-4.6	4.8	3.0	7.5	6.7	7.3	6.4	5.6
Goods imports (annual volume change in percent)	6.3	7.0	2.0	3.4	4.8	4.2	7.3	9.1	7.5
Goods terms of trade (percent change)	-0.7	-0.7	2.9	4.7	-2.9	-1.9	1.3	1.8	1.2
Exchange rate									
Hryvnia per U.S. dollar (end of period; actual)	...	27.2	...	...	...	...	...	...	...
Hryvnia per U.S. dollar (period average; actual)	...	25.6	...	...	...	...	...	...	...
Real effective rate (deflator-based, percent change)	-3.3	0.2	3.2	0.4	2.4	1.6	4.0	3.0	3.5
Real effective rate (deflator-based, 2010=100)	79.0	82.2	81.5	82.5	83.5	83.8	87.1	89.7	92.8
Memorandum items:									
Per capita GDP / Population (2016): US$2,189 / 42.6 million									
Literacy / Poverty rate (2015): 100 percent / 6.4 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 2a. Ukraine: General Government Finances, 2015–21 1/

(Billions of Ukrainian Hryvnias)

	2015	2016		2017		2018	2019	2020	2021
	Act.	3rd Review SR	Act.	3rd Review SR	Proj.	Proj.	Proj.	Proj.	Proj.
Revenue	832.9	914.1	914.1	1,064.6	1,065.5	1,194.5	1,325.8	1,458.8	1,595.1
Tax revenue	702.0	788.0	788.0	941.0	941.9	1,068.5	1,185.6	1,304.2	1,424.6
Tax on income, profits, and capital gains	139.0	199.0	199.0	229.2	227.9	255.8	285.8	314.5	343.8
Personal income tax	100.0	138.8	138.8	165.4	164.8	191.0	213.7	235.0	256.1
Corporate profit tax 2/	39.1	60.2	60.2	63.8	63.1	64.8	72.1	79.5	87.7
Social security contributions	190.4	131.8	131.8	165.7	165.0	191.3	214.1	235.4	256.6
Property tax	16.0	25.0	25.0	24.3	24.3	27.3	30.4	33.5	37.0
Tax on goods and services	261.8	344.4	344.4	423.8	426.7	486.4	537.0	590.3	644.1
VAT	178.5	235.5	235.5	293.1	294.8	338.6	373.2	410.6	448.8
Excise	70.8	101.8	101.8	124.8	125.7	141.2	156.4	171.5	186.4
Other	12.6	7.1	7.1	5.9	6.2	6.6	7.3	8.1	8.9
Tax on international trade	40.3	20.4	20.4	22.8	22.8	25.4	27.7	30.4	32.9
Other tax	54.4	67.4	67.4	75.3	75.3	82.2	90.7	100.2	110.1
Nontax revenue	130.9	126.1	126.1	123.6	123.6	126.0	140.2	154.6	170.6
Expenditure	855.9	967.1	967.1	1,146.5	1,147.4	1,370.8	1,556.9	1,743.4	1,901.1
Current	806.1	892.3	892.3	1,057.0	1,057.9	1,262.3	1,432.1	1,599.4	1,734.8
Compensation of employees	185.6	221.7	221.7	296.4	296.4	363.9	412.0	444.4	469.5
Goods and services	146.5	159.4	159.4	178.5	178.7	194.6	209.1	230.5	254.2
Interest	82.8	97.7	97.7	113.7	114.4	131.5	139.2	149.0	159.1
Subsidies to corporations and enterprises	25.6	23.4	23.4	32.3	32.3	35.4	37.7	39.8	41.8
Social benefits	364.0	388.3	388.3	433.7	433.7	534.3	631.2	732.6	807.0
Social programs (on budget)	75.6	110.5	110.5	126.8	126.8	142.6	158.7	175.0	193.1
Pensions	265.8	254.8	254.8	283.2	283.2	365.9	444.8	528.2	582.7
Unemployment, disability, and accident	22.7	23.0	23.0	23.7	23.7	25.8	27.7	29.4	31.2
Other current expenditures	1.6	1.8	1.8	2.5	2.5	2.7	2.9	3.0	3.2
Capital	46.7	73.0	73.0	77.4	77.4	89.7	103.9	120.9	140.8
Net lending	3.1	1.8	1.8	8.6	8.6	9.6	10.7	11.8	13.0
Contingency reserve	0.0	0.0	0.0	3.5	3.5	9.2	10.3	11.3	12.5
Unidentified measures	0.0	0.0	0.0	0.0	0.0	99.5	152.4	205.3	222.7
General government overall balance	-23.1	-53.0	-53.0	-81.8	-81.8	-76.9	-78.7	-79.2	-83.2
Naftogaz operational balance	-20.5	-1.0	-1.0	0.0	0.0	0.0	0.0	0.0	0.0
General government and Naftogaz balance	-43.6	-54.0	-54.0	-81.8	-81.8	-76.8	-78.7	-79.2	-83.3
General government financing	23.1	53.0	53.0	81.8	81.8	76.9	78.7	79.2	83.2
External	101.3	35.4	35.4	76.2	78.7	48.5	-67.8	-73.8	5.7
Disbursements	133.5	47.6	47.6	104.6	108.0	104.0	98.7	96.7	115.4
Amortizations	-32.2	-12.3	-12.3	-28.3	-29.3	-55.6	-166.5	-170.5	-109.7
Domestic (net)	-78.3	17.6	17.6	5.6	3.1	28.4	146.5	153.0	77.5
Bond financing 3/	-55.0	21.7	19.7	-11.5	-14.0	12.5	111.8	116.5	63.2
Direct bank borrowing	-1.7	-2.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Deposit finance	-31.2	-2.7	-2.7	0.0	0.0	0.0	17.0	17.0	0.0
Privatization	9.6	0.7	0.7	17.1	17.1	15.9	17.7	19.5	14.4
Naftogaz financing	20.5	1.0	1.0	0.0	0.0	0.0	0.0	0.0	0.0
Government financing 4/	29.9	0.1	0.1	37.8	37.8	0.0	0.0	0.0	0.0
Change in external arrears	0.0	0.0	0.0	-37.8	-37.8	0.0	0.0	0.0	0.0
Other 5/	-9.4	0.9	0.9	0.0	0.0	0.0	0.0	0.0	0.0
Bank and DGF recapitalization	45.3	129.0	129.0	98.0	98.0	0.0	0.0	0.0	0.0
Total financing	88.9	183.0	183.0	179.8	179.8	76.8	78.7	79.2	83.3
Memorandum items:									
Primary balance	59.7	44.7	44.7	31.8	32.6	54.6	60.5	69.8	75.9
Cyclically-adjusted primary balance 6/	119.1	77.2	77.2	49.7	50.5	65.0	67.2	72.7	76.0
Structural primary balance 6/ 7/	71.2	69.8	69.8	26.5	27.2	65.0	67.2	72.7	76.0
Public and publicly-guaranteed debt	1,578	1,936	1,936	2,400	2,456	2,624	2,673	2,701	2,732

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

1/ National methodology, cash basis.

2/ Assumes excess CIT payments are cleared over 2017-18.

3/ Domestic bonds have been adjusted to reflect discrepancy between the above-the-line and the below-the-line deficits.

4/ Government spending on Naftogaz financing and recapitalization, including through T-bills issuance.

5/ Includes external and domestic net disbursements, domestic arrears accumulation, and deposit drawdowns.

6/ For the calculation of these balances, it is asumed that the unidentified measures are on the expenditure side.

7/ The balance in 2015 treats import duty surcharges, part of the NBU profit transfer, nonpayment of pensions for working pensioners and advancement of 2016 pensions as one-off operations. This advanced pension payment and the advancement of 2017 pensions to 2016, as well as the nonpayment of pensions for working pensioners are also part of the 2016/17 balances. Part of the NBU profit transfer in 2017 is considered a one-off operation.

Table 2b. Ukraine: General Government Finances, 2015–21 1/

(Percent of GDP)

	2015	2016		2017		2018	2019	2020	2021
	Act.	3rd Review SR	Act.	3rd Review SR	Proj.	Proj.	Proj.	Proj.	Proj.
Revenue	41.9	40.1	38.4	40.5	39.0	38.9	38.8	38.7	38.3
Tax revenue	35.3	34.6	33.1	35.8	34.5	34.8	34.7	34.6	34.2
Tax on income, profits, and capital gains	7.0	8.7	8.4	8.7	8.3	8.3	8.4	8.3	8.3
Personal income tax	5.0	6.1	5.8	6.3	6.0	6.2	6.2	6.2	6.2
Corporate profit tax 2/	2.0	2.6	2.5	2.4	2.3	2.1	2.1	2.1	2.1
Social security contributions	9.6	5.8	5.5	6.3	6.0	6.2	6.3	6.2	6.2
Property tax	0.8	1.1	1.0	0.9	0.9	0.9	0.9	0.9	0.9
Tax on goods and services	13.2	15.1	14.5	16.1	15.6	15.8	15.7	15.6	15.5
VAT	9.0	10.3	9.9	11.2	10.8	11.0	10.9	10.9	10.8
Excise	3.6	4.5	4.3	4.8	4.6	4.6	4.6	4.5	4.5
Other	0.6	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2
Tax on international trade	2.0	0.9	0.9	0.9	0.8	0.8	0.8	0.8	0.8
Other tax	2.7	3.0	2.8	2.9	2.8	2.7	2.7	2.7	2.6
Nontax revenue	6.6	5.5	5.3	4.7	4.5	4.1	4.1	4.1	4.1
Expenditure	43.0	42.4	40.6	43.7	42.0	44.6	45.5	46.2	45.7
Current	40.5	39.1	37.4	40.3	38.7	41.1	41.9	42.4	41.7
Compensation of employees	9.3	9.7	9.3	11.3	10.8	11.8	12.0	11.8	11.3
Goods and services	7.4	7.0	6.7	6.8	6.5	6.3	6.1	6.1	6.1
Interest	4.2	4.3	4.1	4.3	4.2	4.3	4.1	3.9	3.8
Subsidies to corporations and enterprises	1.3	1.0	1.0	1.2	1.2	1.2	1.1	1.1	1.0
Social benefits	18.3	17.0	16.3	16.5	15.9	17.4	18.4	19.4	19.4
Social programs (on budget)	3.8	4.8	4.6	4.8	4.6	4.6	4.6	4.6	4.6
Pensions	13.4	11.2	10.7	10.8	10.4	11.9	13.0	14.0	14.0
Unemployment, disability, and accident	1.1	1.0	1.0	0.9	0.9	0.8	0.8	0.8	0.7
Other current expenditures	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Capital	2.4	3.2	3.1	2.9	2.8	2.9	3.0	3.2	3.4
Net lending	0.2	0.1	0.1	0.3	0.3	0.3	0.3	0.3	0.3
Contingency reserve	0.0	0.0	0.0	0.1	0.1	0.3	0.3	0.3	0.3
Unidentified measures	0.0	0.0	0.0	0.0	0.0	3.2	4.5	5.4	5.4
General government overall balance	-1.2	-2.3	-2.2	-3.1	-3.0	-2.5	-2.3	-2.1	-2.0
Naftogaz operational balance	-1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
General government and Naftogaz balance	-2.2	-2.4	-2.3	-3.1	-3.0	-2.5	-2.3	-2.1	-2.0
General government financing	1.2	2.3	2.2	3.1	3.0	2.5	2.3	2.1	2.0
External	5.1	1.6	1.5	2.9	2.9	1.6	-2.0	-2.0	0.1
Disbursements	6.7	2.1	2.0	4.0	4.0	3.4	2.9	2.6	2.8
Amortizations	-1.6	-0.5	-0.5	-1.1	-1.1	-1.8	-4.9	-4.5	-2.6
Domestic (net)	-3.9	0.8	0.7	0.2	0.1	0.9	4.3	4.1	1.9
Bond financing 3/	-2.8	1.0	0.8	-0.4	-0.5	0.4	3.3	3.1	1.5
Direct bank borrowing	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Deposit finance	-1.6	-0.1	-0.1	0.0	0.0	0.0	0.5	0.5	0.0
Privatization	0.5	0.0	0.0	0.7	0.6	0.5	0.5	0.5	0.3
Naftogaz financing	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Government financing 4/	1.5	0.0	0.0	1.9	1.9	0.0	0.0	0.0	0.0
Accumulation of external arrears	0.0	0.0	0.0	-1.9	-1.9	0.0	0.0	0.0	0.0
Other 5/	-0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Bank and DGF recapitalization	2.3	5.7	5.4	3.7	3.6	0.0	0.0	0.0	0.0
Total financing	4.5	8.0	7.7	6.8	6.6	2.5	2.3	2.1	2.0
Memorandum items:									
Primary balance	3.0	2.0	1.9	1.2	1.2	1.8	1.8	1.8	1.8
Cyclically-adjusted primary balance 6/	6.0	3.4	3.2	1.9	1.8	2.1	2.0	1.9	1.8
Structural primary balance 6/ 7/	3.6	3.1	2.9	1.0	1.0	2.1	2.0	1.9	1.8
Public and publicly-guaranteed debt	79.3	84.9	81.2	91.4	89.8	85.3	78.1	71.6	65.6

Sources: Ministry of Finance; National Bank of Ukraine; and IMF staff estimates and projections.
1/ National methodology, cash basis.
2/ Assumes excess CIT payments are cleared over 2017-18.
3/ Domestic bonds have been adjusted to reflect discrepancy between the above-the-line and the below-the-line deficits.
4/ Government spending on Naftogaz financing and recapitalization, including through T-bills issuance.
5/ Includes external and domestic net disbursements, domestic arrears accumulation, and deposit drawdowns.
6/ For the calculation of these balances, it is asumed that the unidentified measures are on the expenditure side.
7/ The balance in 2015 treats import duty surcharges, part of the NBU profit transfer, nonpayment of pensions for working pensioners and advancement of 2016 pensions as one-off operations. This advanced pension payment and the advancement of 2017 pensions to 2016, as well as the nonpayment of pensions for working pensioners are also part of the 2016/17 balances. Part of the NBU profit transfer in 2017 is considered a one-off operation.

Table 3. Ukraine: Balance of Payments, 2015–21 1/

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

	2015	2016		2017		2018	2019	2020	2021
	Act.	3rd Review SR	Act.	3rd Review SR	Proj.	Proj.	Proj.	Proj.	Proj.
A. Current account balance	-0.3	-3.4	-3.4	-2.9	-3.5	-3.0	-2.6	-2.8	-3.8
Goods (net)	-3.3	-6.8	-6.8	-5.0	-5.6	-5.8	-5.7	-6.5	-7.3
Exports	35.4	33.6	33.6	36.8	36.8	39.2	42.5	46.0	49.3
Imports	-38.7	-40.4	-40.4	-41.9	-42.5	-45.0	-48.2	-52.5	-56.5
Of which : gas	-4.4	-2.3	-2.3	-2.4	-2.4	-2.7	-2.9	-3.2	-3.2
Services (net)	1.6	1.2	1.2	1.2	1.2	1.6	1.8	1.8	1.7
Receipts	12.4	12.3	12.3	13.0	13.0	13.9	14.7	15.6	16.4
Payments	-10.8	-11.1	-11.1	-11.8	-11.8	-12.3	-13.0	-13.8	-14.7
Primary income (net)	-1.2	-0.7	-0.7	-1.6	-1.6	-1.5	-1.4	-0.9	-1.0
Secondary income (net)	2.6	2.9	2.9	2.6	2.6	2.7	2.7	2.7	2.7
B. Capital account balance 2/	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
C. Financial account balance	4.9	-3.7	-3.7	-1.6	-1.6	-7.3	-3.5	-3.5	-5.6
Direct investment (net) 3/	-3.0	-3.4	-3.4	-1.7	-1.7	-2.5	-3.7	-4.4	-4.6
Portfolio investment (net)	2.4	-0.3	-0.3	-1.0	-1.0	-2.8	1.5	0.9	-0.5
Portfolio investment: assets	0.0	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Portfolio investment: liabilities	-2.4	0.2	0.2	1.0	1.0	2.8	-1.5	-0.9	0.5
Equity	0.2	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Debt securities	-2.6	0.2	0.2	1.0	1.0	2.8	-1.5	-0.9	0.5
General government	-1.8	0.3	0.3	1.0	1.0	2.0	-1.8	-1.7	-0.5
Banks	-0.6	-0.1	-0.1	0.0	0.0	0.3	0.1	0.5	0.4
Other sectors	-0.1	0.0	0.0	0.0	0.0	0.5	0.2	0.4	0.7
Financial derivatives (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment (net)	5.5	-0.1	-0.1	1.1	1.0	-2.0	-1.3	0.0	-0.5
Other investment: assets	-1.1	-4.6	-4.6	-1.1	-1.1	-1.0	-0.6	0.0	0.0
Central Bank 4/	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Banks	0.4	-0.7	-0.7	0.5	0.5	0.0	0.0	0.0	0.0
Other sectors	-1.5	-4.0	-4.0	-1.5	-1.6	-1.0	-0.6	0.0	0.0
Of which: FX cash outside the banking system 5/	-1.8	-4.7	-4.7	-1.5	-1.6	-1.0	-0.6	0.0	0.0
Of which: Trade credit	0.5	0.4	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Other investment: liabilities	-6.6	-4.6	-4.6	-2.2	-2.2	1.0	0.7	0.0	0.5
Central Bank 4/	1.5	-1.3	-1.3	0.0	0.0	0.0	0.0	0.0	0.0
General government 6/	-0.3	-0.4	-0.4	-0.5	-0.5	-0.5	-0.7	-1.4	-0.9
Banks 3/	-4.3	-2.6	-2.6	0.4	0.4	0.7	0.6	0.5	0.5
Other sectors	-3.5	-0.3	-0.3	-2.0	-2.0	0.9	0.8	0.8	0.9
Loans	-1.7	-1.0	-1.0	-0.7	-0.7	0.4	0.3	0.3	0.3
Trade credit 7/	-1.7	0.7	0.7	-1.4	-1.4	0.5	0.6	0.6	0.6
D. Errors and omissions	-0.6	-0.5	-0.5	0.0	0.0	0.0	0.0	0.0	0.0
E. Overall balance (A+B-C+D)	-5.3	-0.2	-0.2	-1.3	-1.8	4.4	0.9	0.7	1.9
F. Financing	5.4	0.5	0.5	1.3	1.8	-4.4	-0.9	-0.7	-1.9
Gross official reserves (increase: -)	-6.0	-2.3	-2.3	-6.8	-6.3	-7.7	-0.6	-0.8	-1.1
Net use of IMF resources	5.2	1.0	1.0	4.6	4.6	1.8	-1.5	-1.1	-1.5
Of which: Prospective Fund purchases	6.5	1.0	1.0	5.5	5.5	3.8	0.0	0.0	0.0
Official financing 8/	3.2	1.8	1.8	3.5	3.5	1.5	1.2	1.1	0.7
World Bank/IFC	1.2	0.2	0.2	0.8	0.8	0.5	0.6	0.6	0.3
EU	0.9	0.1	0.1	1.3	1.3	0.0	0.0	0.0	0.0
EBRD/EIB/Others	1.1	1.4	1.4	1.4	1.4	0.9	0.7	0.6	0.4
Exceptional financing	3.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Total external debt (percent of GDP)	130.0	129.4	123.8	128.5	127.4	126.3	114.3	104.6	95.8
Current account balance (percent of GDP)	-0.3	-3.8	-3.8	-3.0	-3.7	-3.0	-2.4	-2.3	-2.9
Goods and services trade balance (percent of GDP)	-1.9	-6.3	-6.3	-4.0	-4.8	-4.2	-3.5	-3.8	-4.2
Gross international reserves	13.3	15.5	15.5	22.3	21.8	29.5	30.1	30.8	32.0
Months of next year's imports of goods and services	3.1	3.5	3.4	4.7	4.6	5.8	5.4	5.2	5.0
Percent of short-term debt (remaining maturity)	48.0	59.2	59.2	79.7	78.0	92.3	85.5	85.5	84.2
Percent of the IMF composite metric	51.4	62.2	61.9	83.9	82.0	102.4	101.3	101.8	102.4
Goods export value (percent change)	-29.9	-5.2	-5.2	9.7	9.7	6.5	8.4	8.3	7.0
Goods import value (percent change)	-33.9	4.2	4.2	3.7	5.2	6.0	7.0	9.0	7.7
Goods export volume (percent change)	-12.7	-3.4	-4.6	4.8	3.0	6.7	7.3	6.4	5.6
Goods import volume (percent change)	-28.8	6.3	7.0	2.0	3.4	4.2	7.3	9.1	7.5
Goods terms of trade (percent change)	-14.6	-0.7	-0.7	2.9	4.7	-1.9	1.3	1.8	1.2
Gross domestic product (current prices)	90.5	89.2	89.2	…	…	…	…	…	…

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

1/ Based on BPM6.

2/ Official capital transfers are reported below the line.

3/ Includes banks' debt for equity operations in 2015 and 2016.

4/ Reflects currency swap transactions.

5/ Mainly reflects residents' conversion of UAH cash to FX held outside the banking system and its usage to finance informal trade.

6/ Only reflects principal amortization. Disbursements from the World Bank, IFC, EU, EIB, EBRD, and official bilaterals are recorded below the line.

7/ Includes clearance of Naftogaz potential arrears to Gazprom in 2017.

8/ Includes project financing to the public and private sector. The Eurobond issuance of US$2 billion with U.S. guarantees is included above the line in portfolio investment: liabilities, debt securities, and general government.

Table 4. Ukraine: Gross External Financing Requirements, 2015–21
(Billions of U.S. dollars)

	2015	2016		2017		2018	2019	2020	2021
	Act.	3rd Review SR	Act.	3rd Review SR	Proj.	Proj.	Proj.	Proj.	Proj.
Total financing requirements	42.1	25.3	25.3	34.1	34.6	34.7	38.9	43.1	44.5
Current account deficit	0.3	3.4	3.4	2.9	3.5	3.0	2.6	2.8	3.8
Portfolio investment	4.3	1.0	1.0	0.0	0.0	0.2	5.0	5.1	4.2
Private	0.8	0.1	0.1	0.0	0.0	0.2	1.2	1.4	0.7
General government	3.5	0.8	0.8	0.0	0.0	0.0	3.8	3.7	3.5
Medium and long-term debt	12.3	6.7	6.7	6.2	6.2	7.6	6.3	9.1	9.8
Private	12.0	6.3	6.3	5.7	5.7	7.1	5.6	7.7	9.0
Banks	4.1	3.0	3.0	0.5	0.5	1.0	1.4	1.6	2.0
Corporates	7.8	3.3	3.3	5.2	5.2	6.1	4.3	6.1	7.0
General government	0.3	0.4	0.4	0.5	0.5	0.5	0.7	1.4	0.9
Short-term debt (including deposits)	15.5	6.0	6.0	13.5	13.5	13.7	13.8	13.8	13.8
Other net capital outflows 1/	-1.1	-3.6	-3.6	-1.1	-1.1	-1.0	-0.6	0.0	0.0
Trade credit	10.9	11.9	11.9	12.6	12.6	11.2	11.8	12.3	12.9
Total financing sources	37.8	25.5	25.5	33.7	33.7	39.1	39.8	43.8	46.4
Capital transfers 2/	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Direct investment, net	3.0	3.4	3.4	1.7	1.7	2.5	3.7	4.4	4.6
Portfolio investment	1.9	1.2	1.2	1.0	1.0	3.0	3.5	4.3	4.8
Private	0.3	0.1	0.1	0.0	0.0	1.0	1.5	2.3	1.8
General government	1.7	1.1	1.1	1.0	1.0	2.0	2.0	2.0	3.0
Of which : Eurobond issuance	1.0	1.0	1.0	1.0	1.0	2.0	2.0	2.0	3.0
Medium and long-term debt	7.3	2.5	2.5	6.0	6.0	7.7	6.3	8.2	9.5
Private	7.3	2.5	2.5	6.0	6.0	7.7	6.3	8.2	9.5
Banks	1.2	0.2	0.2	0.8	0.8	1.4	1.7	1.9	2.3
Corporates	6.1	2.3	2.3	5.2	5.2	6.4	4.6	6.3	7.2
General government 2/	...	...	...	...	...	...	...	...	...
Short-term debt (including deposits)	14.2	5.9	5.9	13.8	13.8	14.1	14.0	14.0	14.0
Trade credit	11.0	12.6	12.6	11.2	11.2	11.8	12.3	12.9	13.5
Increase in gross reserves	6.0	2.3	2.3	6.8	6.3	7.7	0.6	0.8	1.1
Errors and omissions	-0.6	-0.5	-0.5	0.0	0.0	0.0	0.0	0.0	0.0
Total financing needs	9.6	2.6	2.6	7.2	7.2	3.3	-0.3	0.1	-0.7
Official financing	8.3	2.8	2.8	7.2	7.2	3.3	-0.3	0.1	-0.7
IMF	5.2	1.0	1.0	4.6	4.6	1.8	-1.5	-1.1	-1.5
Prospective purchases	6.5	1.0	1.0	5.5	5.5	3.8	0.0	0.0	0.0
Repurchases	1.4	0.0	0.0	0.8	0.8	2.0	1.5	1.1	1.5
Official creditors 3/	3.2	1.8	1.8	2.6	2.6	1.5	1.2	1.1	0.7
World Bank	1.2	0.2	0.2	0.2	0.2	0.5	0.6	0.6	0.3
EU	0.9	0.1	0.1	1.3	1.3	0.0	0.0	0.0	0.0
EBRD/EIB/Others	1.1	1.4	1.4	1.1	1.1	0.9	0.7	0.6	0.4
Exceptional financing	3.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Gross international reserves	13.3	15.5	15.5	22.3	21.8	29.5	30.1	30.8	32.0
Months of next year's imports of goods and services	3.1	3.5	3.4	4.7	4.6	5.8	5.4	5.2	5.0
Percent of short-term debt (remaining maturity)	48.0	59.2	59.2	79.7	78.0	92.3	85.5	85.5	84.2
Percent of the IMF composite metric 4/	51.4	62.2	61.9	83.9	82.0	102.4	101.3	101.8	102.4
Loan rollover rate (percent) 5/									
Banks	87.8	101.1	101.1	105.4	105.4	109.4	107.7	106.7	106.4
Corporates	82.8	280.3	280.3	101.9	101.9	102.7	102.4	101.9	101.9
Total	79.7	132.7	132.7	103.1	103.1	105.0	104.5	103.6	103.5

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

1/ Reflects changes in banks', corporates', and households' gross foreign assets as well as currency swap transactions.

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

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

4/ The IMF composite measure is calculated as a weighted sum of short-term debt, other portfolio and investment liabilities, broad money, and exports. Official reserves are recommended to be in the range of 100–150 percent of the appropriate measure.

5/ For banks, rollover rates (including short-term, long-term loans and non-resident deposits) are adjusted to exclude the impact of debt relief and debt for equity operations reflected on capital transfers and FDI, respectively. For corporates, rollover rates include as financing not only new inflows but also the deferment of external liabilities through the ongoing restructuring of private sector debt.

Table 5. Ukraine: Monetary Accounts, 2015–21

(Billions of Ukrainian hryvnias, unless otherwise noted)

	2015	2016		2017					2018	2019	2020	2021
	Dec.	Dec.		Mar.	Jun.	Sep.	Dec.					
	Act.	3rd Review SR	Act.	Proj.	Proj.	Proj.	3rd Review SR	Proj.	Proj.	Proj.	Proj.	Proj.
Monetary survey												
Net foreign assets	-35	64	64	66	73	53	110	100	256	305	348	412
(In billions of U.S. dollars)	-1.4	2.4	2.4	2.4	2.6	1.8	3.8	3.3	8.4	9.9	11.2	13.3
Net domestic assets	1,029	1,038	1,038	1,029	1,053	1,117	1,116	1,123	1,201	1,376	1,587	1,758
Domestic credit	1,503	1,673	1,673	987	1,023	1,081	1,808	1,810	1,914	2,157	2,411	2,621
Net claims on government	466	624	624	0	0	0	685	683	695	824	957	1,021
Credit to the economy	1,013	1,003	1,003	987	1,023	1,081	1,077	1,081	1,172	1,286	1,407	1,554
Domestic currency	465	508	508	494	538	574	568	575	614	691	773	897
Foreign currency	548	494	494	493	485	507	508	506	558	596	634	657
(In billions of U.S. dollars)	22.9	18.4	18.2	17.9	17.3	17.5	17.5	16.9	18.3	19.3	20.5	21.2
Other items, net	-475	-635	-635	42	30	36	-691	-687	-712	-780	-824	-863
Broad money	994	1,103	1,103	1,095	1,126	1,170	1,227	1,222	1,458	1,682	1,935	2,169
Currency in circulation	283	314	314	311	323	325	352	350	387	429	475	528
Total deposits	711	788	788	784	803	845	875	872	1,070	1,252	1,460	1,641
Domestic currency deposits	392	426	426	421	441	464	469	468	573	696	810	912
Foreign currency deposits	320	362	362	363	362	381	406	404	497	556	650	729
(In billions of U.S. dollars)	13.3	13.5	13.3	13.2	12.9	13.1	14.0	13.5	16.3	18.1	21.0	23.5
Accounts of the NBU												
Net foreign assets	34	116	116	126	141	129	190	182	360	428	487	568
(In billions of U.S. dollars)	1.4	4.3	4.3	4.6	5.0	4.5	6.5	6.1	11.8	13.9	15.8	18.3
Net international reserves	32	115	115	124	139	128	188	180	359	426	486	566
(In billions of U.S. dollars)	1.4	4.3	4.2	4.5	5.0	4.4	6.5	6.0	11.8	13.9	15.7	18.3
Reserve assets	319	423	423	468	549	579	648	657	899	925	953	990
(In billions of U.S. dollars)	13.3	15.7	15.5	16.9	19.5	20.0	22.3	21.9	29.5	30.1	30.8	32.0
Other net foreign assets	2	2	2	2	2	2	2	2	2	2	2	2
Net domestic assets	302	265	265	261	264	283	243	250	126	116	121	109
Net domestic credit	375	358	358	353	321	347	318	321	183	202	218	221
Net claims on government	363	355	355	361	307	317	323	323	264	203	172	159
Claims on government 1/	414	403	403	407	394	383	371	371	312	234	186	173
Liabilities to government 2/	51	48	48	46	87	66	48	48	48	31	14	14
o/w central gov. deposits												
Net claims on the economy	0	0	0	0	0	0	0	0	0	0	0	0
Net claims on banks	13	3	3	-8	14	30	-4	-1	-81	-1	45	63
Other items, net	-74	-93	-93	-92	-57	-64	-75	-71	-58	-86	-97	-112
Base money	336	382	382	386	405	412	433	431	486	545	608	677
Currency in circulation	283	314	314	311	323	325	352	350	387	429	475	528
Banks' reserves	53	67	67	75	81	88	82	81	99	115	134	149
Cash in vault 3/	26	27	27	27	27	29	30	30	36	42	49	56
Correspondent accounts	28	41	41	49	54	59	52	52	63	73	84	94
Deposit money banks												
Net foreign assets	-69	-52	-52	-60	-68	-76	-79	-82	-104	-123	-140	-156
(In billions of U.S. dollars)	-2.9	-1.9	-1.9	-2.2	-2.4	-2.6	-2.7	-2.7	-3.4	-4.0	-4.5	-5.0
Foreign assets	181	178	178	178	178	180	177	183	179	173	166	159
(In billions of U.S. dollars)	7.6	6.6	6.6	6.4	6.3	6.2	6.1	6.1	5.9	5.6	5.4	5.1
Foreign liabilities	250	230	230	236	243	253	256	265	283	296	306	316
Net domestic assets	780	840	840	843	870	921	954	954	1,174	1,375	1,599	1,797
Domestic credit	1,217	1,417	1,417	1,434	1,475	1,539	1,606	1,605	1,864	2,105	2,361	2,583
Net claims on government 4/	104	269	269	283	304	320	362	360	431	621	785	862
Credit to the economy	1,013	1,002	1,002	987	1,023	1,081	1,076	1,081	1,172	1,286	1,407	1,554
Other claims on the economy	23	46	46	46	46	46	46	46	46	46	46	46
Net claims on NBU	77	99	99	118	102	92	121	118	215	151	123	122
Of which : refinancing loans	106	75	75	73	70	68	68	68	61	55	51	51
Other items, net 4/	-438	-577	-577	-591	-605	-619	-652	-651	-690	-730	-762	-786
Banks' liabilities	711	788	788	783	802	845	875	872	1,070	1,252	1,459	1,641
Demand deposits	291	...	...				...	...	...	...	...	...
Savings and time deposits	420	...	...				...	...	...	...	...	...
Memorandum items:				(End of period, percent change unless otherwise noted)								
Base money	0.8	13.6	13.6	1.3	6.1	8.1	13.6	13.0	12.7	12.0	11.7	11.3
Currency in circulation	-0.1	11.2	11.2	-1.1	2.9	3.3	11.8	11.3	10.5	10.9	10.7	11.1
Broad money	3.9	10.9	10.9	-0.7	2.1	6.1	11.3	10.8	19.2	15.4	15.1	12.1
At program exchange rate	-7.6	7.5	7.5	-1.2	1.8	4.9	9.3	8.4	18.2	15.8	14.6	12.1
Credit to the economy	-1.0	-1.1	-1.1	-1.6	2.1	7.8	7.4	7.8	8.4	9.7	9.4	10.5
At program exchange rate	-19.4	-3.7	-3.7	-2.4	2.0	6.9	5.8	5.8	7.4	10.3	10.1	12.3
Real credit to the economy 5/	-30.9	-12.0	-12.0	-17.4	-8.5	-2.8	-2.4	-2.0	1.3	3.5	4.2	5.2
Credit-to-GDP ratio, in percent	51.2	44.0	42.1	40.6	40.6	41.3	41.0	39.5	38.1	37.6	37.3	37.3
Velocity of broad money, ratio	1.99	1.82	1.83	2.22	2.24	2.24	2.14	2.24	2.11	2.03	1.95	1.92
Money multiplier, ratio	2.96	2.89	2.89	2.83	2.78	2.84	2.83	2.83	3.00	3.09	3.18	3.20

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

1/ Includes purchases of Naftogaz and PrivatBank recapitalization bonds and DGF financing.

2/ Liabilities include advances for NBU profit transfer and deposits of DGF.

3/ During 2015 only, cash in vault was counted towards required reserves.

4/ Includes claims for recapitalization of banks.

5/ Deflated by CPI (eop), at current exchange rates, year-on-year percent change.

Table 6. Ukraine: Indicators of Fund Credit, 2015–25

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
	Actual		Projection								
Stock of existing and prospective Fund credit 1/ 2/3/											
In millions of SDRs	7,701	8,417	11,846	13,206	12,053	11,264	10,178	8,476	6,418	4,360	2,597
In percent of quota	561	418	589	656	599	560	506	421	319	217	129
In percent of GDP	11.8	12.5	16.6	17.3	14.4	12.3	10.2	7.7	5.0	3.2	1.8
In percent of exports of goods and services	22.5	25.5	31.9	33.4	28.3	24.6	20.8	16.3	11.6	7.4	4.1
In percent of gross reserves	81.0	75.3	72.9	60.1	53.9	49.1	42.8	34.5	27.8	21.4	14.6
Stock of existing Fund credit 1/ 2/3/											
In millions of SDRs	7,701	8,417	7,788	6,302	5,149	4,361	3,453	2,546	1,639	731	119
In percent of quota	561	418	387	313	256	217	172	127	81	36	6
In percent of GDP	11.8	12.5	10.9	8.3	6.2	4.8	3.5	2.3	1.3	0.5	0.1
In percent of exports of goods and services	22.5	25.5	21.0	15.9	12.1	9.5	7.1	4.9	3.0	1.2	0.2
In percent of gross reserves	81.0	75.3	47.9	28.7	23.0	19.0	14.5	10.4	7.1	3.6	0.7
Stock of prospective Fund credit 1/ 2/3/											
In millions of SDRs	0	0	4,058	6,904	6,904	6,904	6,724	5,930	4,779	3,628	2,478
In percent of quota	0	0	202	343	343	343	334	295	238	180	123
In percent of GDP	0.0	0.0	5.7	9.1	8.3	7.6	6.7	5.4	3.7	2.7	1.7
In percent of exports of goods and services	0.0	0.0	10.9	17.4	16.2	15.0	13.8	11.4	8.6	6.1	3.9
In percent of gross reserves	0.0	0.0	25.0	31.4	30.9	30.1	28.3	24.1	20.7	17.8	13.9
Obligations to the Fund from existing and prospective drawings 2/3/											
In millions of SDRs	125	0	881	1,822	1,515	1,161	1,423	1,984	2,261	2,175	1,810
In percent of quota	9	0	44	91	75	58	71	99	112	108	90
In percent of GDP	0.2	0.0	1.2	2.4	1.8	1.3	1.4	1.8	1.8	1.6	1.3
In percent of exports of goods and services	0.4	0.0	2.4	4.6	3.6	2.5	2.9	3.8	4.1	3.7	2.9
In percent of gross reserves	1.3	0.0	5.4	8.3	6.8	5.1	6.0	8.1	9.8	10.7	10.2
Obligations to the Fund from existing drawings 2/3/											
In millions of SDRs	125	0	788	1,540	1,099	661	758	781	826	876	614
In percent of quota	9	0	39	77	55	33	38	39	41	44	31
In percent of GDP	0.2	0.0	1.1	2.0	1.3	0.7	0.8	0.7	0.6	0.6	0.4
In percent of exports of goods and services	0.4	0.0	2.1	3.9	2.6	1.4	1.6	1.5	1.5	1.5	1.0
In percent of gross reserves	1.3	0.0	4.9	7.0	4.9	2.9	3.2	3.2	3.6	4.3	3.4
Obligations to the Fund from prospective drawings 2/3/											
In millions of SDRs	0	0	93	281	416	499	665	1,202	1,436	1,298	1,195
In percent of quota	0	0	5	14	21	25	33	60	71	65	59
In percent of GDP	0.0	0.0	0.1	0.4	0.5	0.5	0.7	1.1	1.1	1.0	0.8
In percent of exports of goods and services	0.0	0.0	0.3	0.7	1.0	1.1	1.4	2.3	2.6	2.2	1.9
In percent of gross reserves	0.0	0.0	0.6	1.3	1.9	2.2	2.8	4.9	6.2	6.4	6.7

Source: IMF staff estimates.

1/ End of period.

2/ Repayment schedule based on repurchase obligations and charges.

3/ For 2015 Ukraine's old quota of SDR 1,372 million applies. Ukraine's new quota of SDR 2,011.8 million became effective in February 2016.

Supplementary Letter of Intent

Kyiv, March 29, 2017

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

Dear Ms. Lagarde:

1. This letter supplements our Letter of Intent of March 2, 2017, and provides information about recent developments that have adversely affected the economic outlook for this year, and describes our policies to mitigate these effects and achieve the objectives of our economic program.

2. An escalation of the situation in the eastern part of Ukraine and an increase in actions against our national and economic security, including the seizure of assets of Ukrainian companies operating in the non-government controlled areas and the disruption of supply chains, led the National Security and Defense Council of Ukraine to decide to temporarily halt trade with the non-government controlled areas and all transport of goods, excluding humanitarian assistance, to and from the non-government controlled areas, until these companies' property rights are restored. These events have clear and immediate negative repercussions for our energy and steel production, and hence for our exports and economic growth. While we expect that companies will gradually adjust their operations, including by finding new suppliers and expanding capacity in government-controlled areas, we expect that growth in 2017 will be almost 1 percentage point lower than previously projected. In addition, while we will aim to limit the adverse impact on the balance of payments by allowing the exchange rate to adjust and maintaining appropriately tight monetary policies, also to meet our inflation objective, the current account deficit is expected to widen to 3¾ percent of GDP this year and the National Bank of Ukraine's (NBU) reserves are projected to reach US$21.8 billion by year-end, about US$0.5 billion less than anticipated earlier. We are firmly committed to continuing our efforts, including by maintaining appropriately tight monetary policies, to catch up with the reserve targets under the program as the economic recovery strengthens in the coming years. Although the recent events have increased uncertainty and the challenges to the budget, including some loss in revenues, we remain committed to meet the budget deficit targets previously agreed, which is critical to continue reducing the still high public debt burden.

3. The recent events also caused a strong negative public reaction to Russian state-owned banks operating in Ukraine. In the interest of our national security, we imposed restrictions on the transactions of these banks with their parent banks, and we have notified the IMF's Executive Board

of these measures under Decision No. 144-(52/51). We will ease these restrictions as soon as security conditions permit.

4. We remain firmly committed to take appropriate measures as needed to safeguard the stability of our financial system. In this regard, as the abovementioned banks are solvent and continue to adhere to prudential regulations and we remain committed to treat banks evenhandedly, we have made arrangements to ensure that these banks have quick access to the necessary liquidity support if needed, including emergency liquidity assistance from the NBU. Moreover, we are firmly committed to adherence to the rule of law, and are ensuring the safety and security of these banks' offices and branches, to allow their continued and uninterrupted operations.

5. Reflecting the changed economic outlook, we propose that the performance criteria for the accumulation of the NBU's net international reserves and net domestic assets for end-June, end-September, and end-December 2017 be set as specified in the attached Table 1; all other performance criteria and indicative targets for end-June, end-September, and end-December 2017 remain as proposed in our letter of March 2, 2017, and as reflected also in the attached Table 1. In addition, we request a waiver of non-observance of the end-March 2017 performance criterion on the accumulation of the NBU's net international reserves, which based on available data is expected to be missed by US$520 million, as a result of the recent developments outlined above and the impact on financial markets from the nationalization of our largest bank. Also, we request a waiver of applicability of all the other end-March 2017 performance criteria as presented in the attached Table 1, which have become controlling for this review, as final data for these performance criteria are not yet available, while there is no indication that these have not been observed. We furthermore request to reset the structural benchmark on the adoption of legislation to merge customs and tax administration into a single legal entity to end-April 2017 (instead of end-March 2017, as had been envisaged in the MEFP of March 2, 2017), as more time is needed to complete the legislative process. With these changes, we request the completion of the third review and the financing assurances review, and the disbursement of SDR 734.05 million.

Yours sincerely,

/s/ Petro Poroshenko President	/s/ Volodymyr Groysman Prime Minister
/s/ Oleksandr Danylyuk Minister of Finance	/s/ Valeria Gontareva Governor, National Bank of Ukraine

Table 1. Ukraine: Quantitative Criteria and Indicative Targets 1/

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

	2017			
	March	June	September	December
	PC	Proposed PC	Proposed PC	Proposed PC
I. Quantitative performance criteria				
Ceiling on the cash deficit of the general government (- implies a surplus) 2/	15,000	29,000	45,000	80,970
Ceiling on the cash deficit of the general government and Naftogaz (- implies a surplus) 2/	-1,100	16,200	52,000	80,970
Floor on cumulative change in net international reserves (in millions of U.S. dollars) 3/ 4/	2,288	3,451	2,894	4,578
Ceiling on cumulative change in net domestic assets of the NBU 3/	22,584	14,301	30,791	23,169
Ceiling on publicly guaranteed debt 2/	15,000	15,000	15,000	15,000
II. Continuous performance criterion				
Non-accumulation of new external debt payments arrears by the general government 4/	0	0	0	0
III. Indicative Targets				
Ceiling on cumulative change in base money 3/	58,655	n.a.	n.a.	n.a.
Inflation (mid-point, percent) 5/	12.0	12.0	10.0	8.0
Ceiling on stock of VAT refund arrears	0	0	0	0
Ceiling on current primary expenditure of the state budget 2/	n.a.	n.a.	n.a.	620,000
General government employment 6/	n.a.	n.a.	3,290,011	n.a.
IV. Memorandum Items				
Naftogaz deficit (- implies a surplus) 2/	-16,100	-12,800	7,000	0
External project financing 2/	4,000	8,000	12,000	16,000
NBU loans to DGF and operations with government bonds issued for DGF financing or banks recapitalization 3/	455	28,027	24,979	23,599
Government bonds issued for banks recapitalization and DGF financing 3/ 7/	6,000	184,000	207,000	227,000
Programmed disbursements of international assistance except IMF (millions of U.S. dollars) 3/ 4/	2,529	2,479	2,534	4,368
Conversion of a non-reserve currency under a central bank swap line into a reserve currency through an outright sale 3/ 4/	0	0	0	0
Net financing from debt operations (millions of U.S. dollars) 3/ 4/	2,199	2,545	4,877	5,846
Projected payments of interest on government bonds held by NBU 2/	10,585	22,880	33,290	44,822
Net issuance of central government domestic FX debt 3/ 4/	-99	1,000	852	701
Program accounting exchange rate, hryvnia per U.S. dollar	15.7686	15.7686	15.7686	15.7686

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

1/ Definitions and adjustors for 2016 and 2017Q1 are specified in the Technical Memorandum of Understanding (TMU) in IMF Country Report No. 16/319 and in the TMU dated March 2, 2017 for 2017Q2 through 2017Q4.

2/ Targets for 2016 are cumulative flows from January 1, 2016. For 2017, cumulative flows from January 1, 2017.

3/ Targets for 2016 and 2017 are cumulative flows from January 1, 2016.

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

5/ End of period, year-on-year headline inflation. Mid-point within a +/- 3 percent range through 2017Q3. Mid-point within a +/- 2 percent rage in 2017Q4.

6/ Excluding salaried military personnel. Actual data reported for end-September 2016 is as of end-June 2016. For the end-September 2017 test dates the reported data is for end-June 2017.

7/ For March 2017, cumulative from January 1, 2017.

INTERNATIONAL MONETARY FUND

UKRAINE

March 7, 2017

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION AND THIRD REVIEW UNDER THE EXTENDED FUND FACILITY AND REQUESTS FOR REPHASING OF ACCESS AND FINANCING ASSURANCES REVIEW

EXECUTIVE SUMMARY

Following the 2014–15 crisis, the economy is growing again and tight fiscal and monetary policies have greatly reduced internal and external imbalances. Inflation has been successfully brought down and reserves—while still being relatively low—have doubled to US$15 billion. The pace of the recovery, however, has been modest, and faster growth is needed if Ukraine is to catch up with its regional peers and lift per capita income levels that have declined to among the lowest in the region.

To accelerate growth while maintaining macroeconomic stability, policies should continue to focus on: (i) accelerating efforts to attract investment and raise the economy's potential by improving the business environment, reforming the large state-owned enterprise (SOE) sector, developing a market for agricultural land, and tackling corruption, which remains a key challenge; (ii) ensuring fiscal sustainability through fiscal consolidation, supported by pension reform, more efficient public spending, and a more equitable and growth-friendly tax system; (iii) further reducing inflation and rebuilding reserves; and (iv) repairing viable banks and reviving sound bank lending.

In terms of program performance, the authorities have continued to make progress, notwithstanding some slippages. All fiscal and monetary performance criteria for end-December 2016 were met and a number of important policy measures have been taken since the last review. This includes the adoption of a 2017 budget consistent with program targets; adoption of an automatic adjustment mechanism to maintain gas and heating tariffs at market levels; a tightening of norms for utility subsidies; the nationalization of the country's largest, but insolvent private bank; and the publication of high-level officials' asset declarations to enhance transparency. However, given the authorities' focus on these challenging measures, several structural benchmarks were missed and have been reset, in line with the program's reform priorities, including on land, SOE, and pension reforms.

Staff supports the completion of the third review and the financing assurances review, as well as the authorities' request for a rephasing of access. The purchase available upon completion of this review would be equivalent to SDR 734.05 million, bringing total purchases under the Extended Fund Facility to SDR 6,178.26 million.

Approved By
Thanos Arvanitis and Mark Flanagan

Discussions were held in Kyiv during November 3–16, 2016. The team comprised Ron van Rooden (head), Stephanie Eble, Ricardo Llaudes, Pamela Madrid, Brett Rayner (EUR), David Amaglobeli (FAD), Jeta Menkulasi (SPR), Emmanuel Mathias, Chanda DeLong (LEG), Luis Cortavarria-Checkley, Jean Portier, Annamaria Kokenyne, Ivan de Oliveira Lima (MCM), Damiano Sandri (RES), Wiktor Krzyzanowski (COM), Jerome Vacher, Wim Fonteyne, Ihor Shpak, Mariia Sydorovych, Maksym Markevych (Resident Representative office). Thanos Arvanitis (Deputy Director EUR) and Oleksandr Petryk (OED) participated in some of the discussions. Alaina Rhee and Christine Rubio (EUR) provided support from headquarters.

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INTRODUCTION

1. Ukraine's economy has been confronted with enormous challenges in recent years. By late 2013, when the last Article IV consultation with Ukraine was concluded, inconsistent policies, weak fundamentals, and an incomplete transition to a market economy had given rise to large imbalances, leaving Ukraine vulnerable to shocks. In 2014–15, large terms of trade shocks, the annexation of Crimea, and the intensification of the conflict in the eastern part of the country led to an economic and financial meltdown.

2. Over the past two years, the authorities have made great strides in stabilizing the economy. After a deep and painful recession, with output contracting by about a quarter in the second half of 2014 and the first half of 2015, the economy is slowly recovering, reflecting the authorities' resolve to strengthen macroeconomic policies, with strong support of the international community. Notably, tight fiscal and monetary policies, a flexible exchange rate, and the initiation of key reforms have been instrumental in turning the economy around and placing it on a path to recovery.

3. Progress in advancing structural reforms, however, has been mixed. While the authorities have been able to take bold actions in the energy and financial sectors under the program, there continue to be delays, particularly in the areas of reforming the state-owned enterprise (SOE) sector, and land and pension reform. To a large extent, divergence of views within the coalition and the political system, and strong resistance from vested interests, have hindered faster progress in these areas.

4. Against this backdrop, the discussions with the authorities focused on: (i) the medium-term challenges in advancing Ukraine's transition to a full-fledged market economy and ensuring durable growth (part of the Article IV discussions), and (ii) conditions for completing the third review.

ECONOMIC DEVELOPMENTS AND OUTLOOK

A. A Dramatic Turnaround

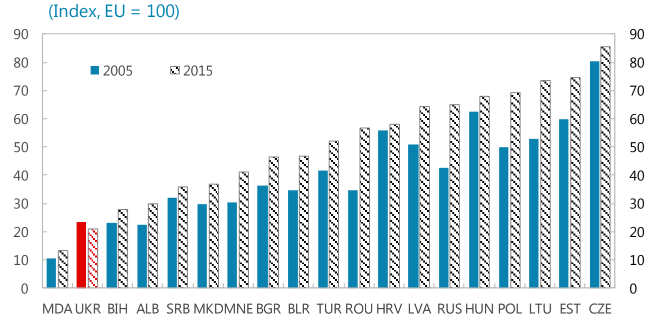
5. Over the last few years, prudent economic policies have resulted in a dramatic reduction in external and internal imbalances. Notably, the adoption of a flexible exchange rate —a key recommendation of past Article IV consultations (Annex I), following years of defending an overvalued rate—strict income policies, and an impressive fiscal consolidation led to a sharp reduction in Ukraine's twin deficits. The current account deficit fell from over 9 percent of GDP in 2013 to 3¾ percent in 2016; and the overall fiscal deficit—including the energy sector's quasi-fiscal deficit—which swelled to 10 percent of GDP in 2014, declined to 2½ percent, supported by strong spending control and the bold decision to raise energy tariffs to import parity (Figure 1).

6. Inflation has been successfully brought down. With strengthened independence and a strong commitment to medium-term price stability, the National Bank of Ukraine (NBU) has steered monetary policy adeptly to ensure that the pass-through of the large shocks to prices—including the sharp depreciation of the exchange rate and the increases in energy tariffs—was short-lived. Inflation has fallen from its peak of 61 percent in April 2015 to 12½ percent by end-2016, very close to the NBU's target.

7. Efforts to clean up the banking system have continued. The crisis brought out the deep vulnerabilities of the banking business model in Ukraine that had suffered from insufficient risk assessment and sizable connected lending, facilitated by weak oversight. Following two rounds of asset quality reviews, decisive efforts are underway to strengthen banks' capitalization and reduce excessive credit concentration. Nearly 90 insolvent banks, including the largest private bank, accounting for more than 50 percent of the banking system's assets in early 2014 have been resolved. Confidence is gradually being restored and deposits are on the rise.

8. Growth is gradually returning, but the cost of the 2014–15 crisis has been severe. Growth is estimated to have reached 2 percent in 2016. The recovery has been relatively broad based, including industry, agriculture, as well as retail trade. However, following the deep recession in 2014–15 and the exchange rate depreciation, dollar GDP is now half of its pre-2014 level and GDP per capita in PPP terms is just 20 percent of the EU average, the second lowest level of all Central and Eastern European countries. Even before the recent crisis, growth was highly volatile, driven in part by swings in non-oil commodity prices, but also weak policies and stop-and-go reforms that resulted in the repeated buildup of large imbalances. On balance, the economy has not grown at all over the last decade and has only grown by a meager annual average of 0.8 percent over the last two decades.

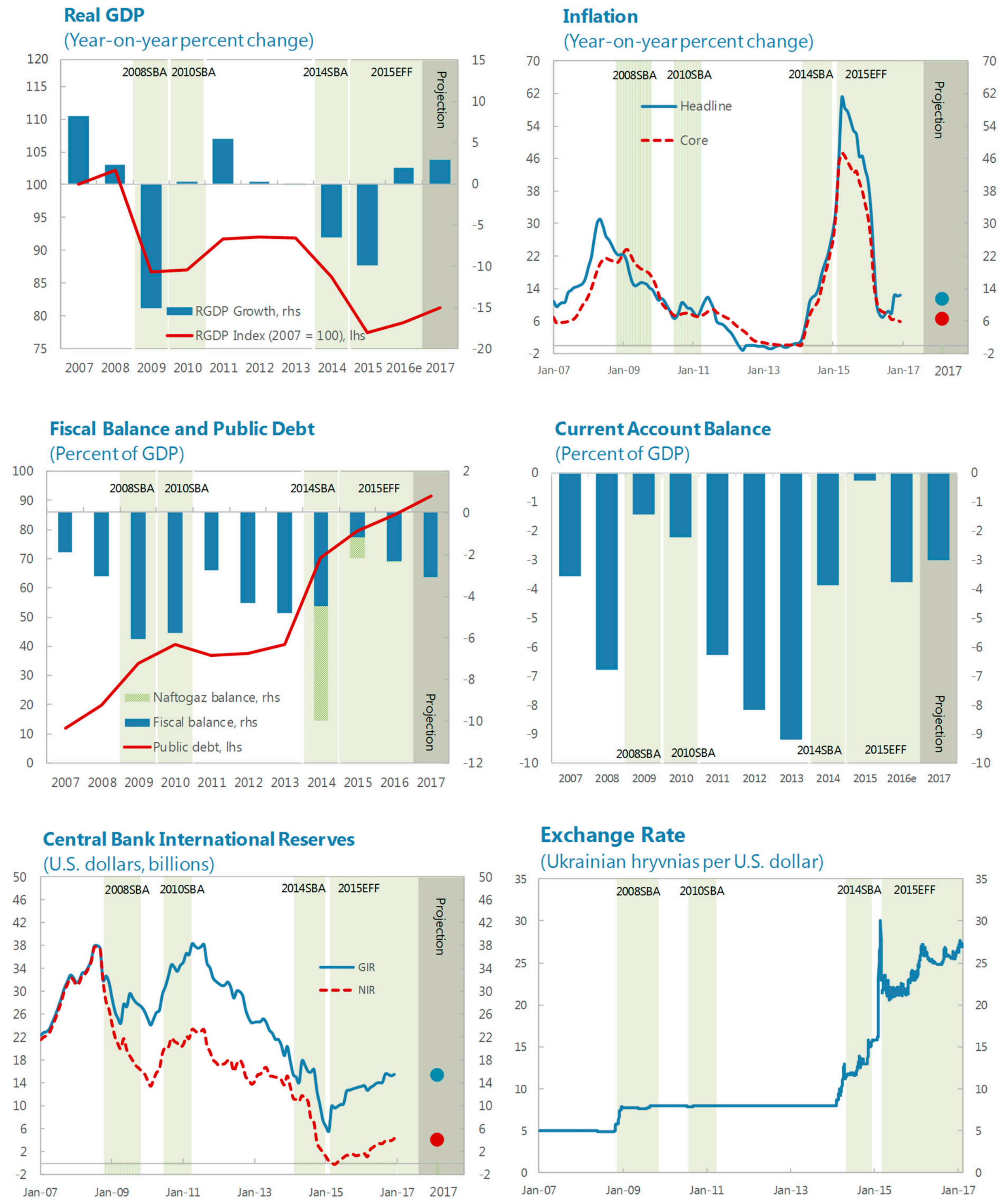
GDP per Capita in PPP Relative to EU Average
(Index, EU = 100)



Sources: World Development Indicators and IMF staff calculations.

9. Moreover, important macroeconomic vulnerabilities and challenges remain. In particular: (i) public and external debt at around 85 and 130 percent of GDP, respectively, remain very high for an emerging market economy; (ii) gross international reserves, while having increased, are still low by standard metrics; (iii) the financial system remains heavily dollarized and strained by record-high non-performing loans; and (iv) the public sector is large and inefficient, while pressures to increase public spending remain strong.

Figure 1. Ukraine: Selected Economic Indicators, 2007–17



Sources: Ukrainian authorities and IMF staff calculations.

B. An Urgent Need for Reforms

10. Ukraine's weak past economic performance largely reflects the incomplete transition to a full-fledged market economy and the poor business environment. Important parts of the economy are dominated by oligarchs and inefficient SOEs, deterring competition and contributing to corruption. Despite some efforts, no large SOE has been privatized in recent years. At the same time, businesses and markets remain subject to excessive regulation and an arbitrary tax administration, notwithstanding recent improvements. A weak judicial system undermines contracts and creates legal uncertainty. A moratorium on agricultural land sales, which was extended for one more year in late 2016, hampers the development of the agricultural sector, where Ukraine has a comparative advantage. As a result, private and foreign investment have been low compared to other countries in the region, limiting potential output (Figure 2).

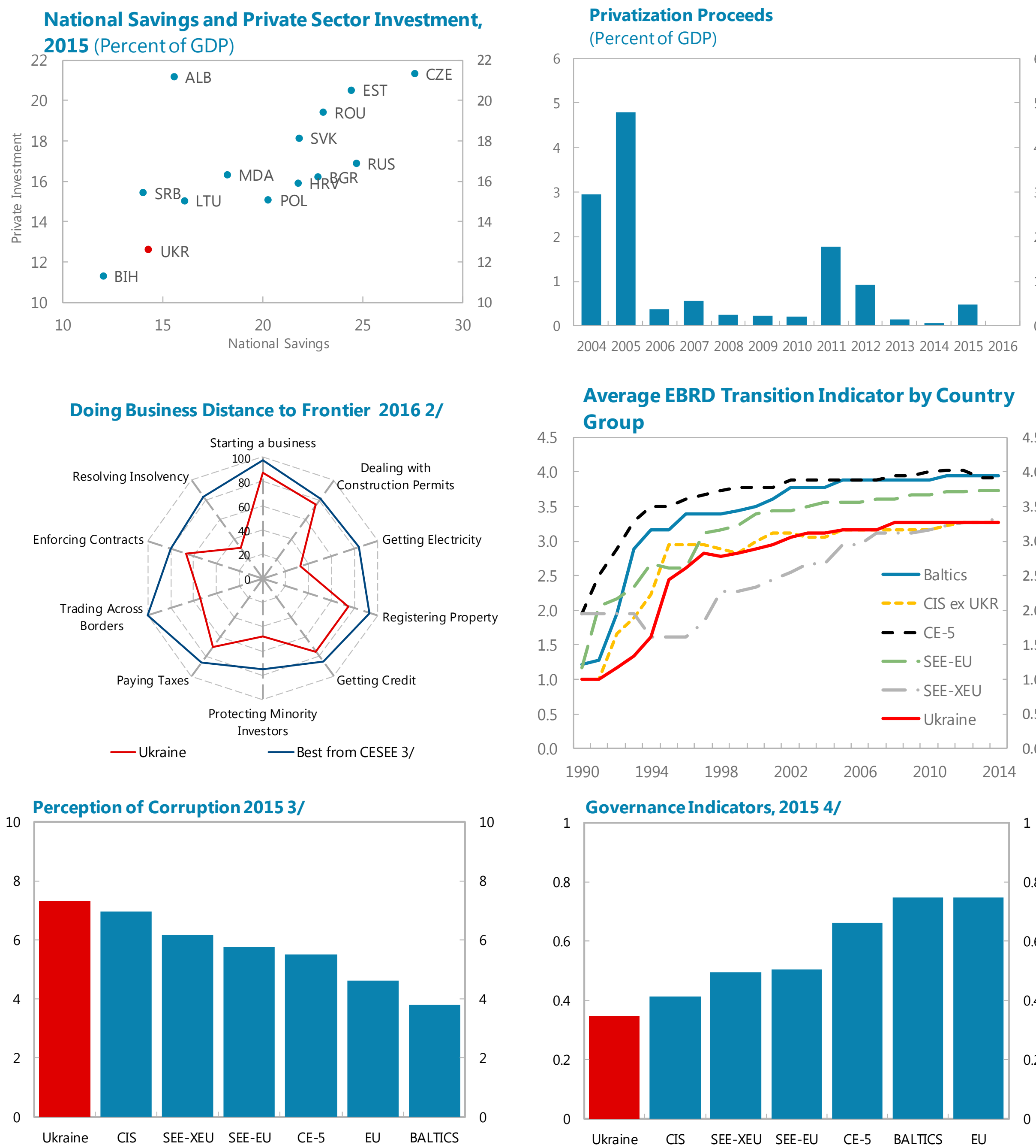
11. At the same time, Ukraine faces labor productivity and trade challenges. With a lack of investment, labor productivity is also low, amounting to less than 10 percent of average productivity in EU countries (Figure 3). Labor participation has declined further in recent years, including due to the migration of younger and skilled workers, while wage pressures are building up. In addition, trade disruptions and commodity price volatility have affected further Ukraine's exports and growth. As a result of the conflict, Ukraine suffered from reduced access to some of its traditional export markets, forcing it to re-orient trade to markets in Europe and Asia (Figure 4). In this regard, the Deep and Comprehensive Free Trade Area (DCFTA) that is part of the Association Agreement with the EU could prove to be helpful in providing Ukraine with new trade opportunities.

12. The recent stabilization provides a promising basis for achieving faster growth. Ukraine has regained its external competitiveness. The real effective exchange rate appears somewhat undervalued by standard models, but taking into account the need for Ukraine to improve its deeply negative net international investment position and its low level of reserves, the exchange rate is assessed broadly in line with Ukraine's broader fundamentals (see Annex II). Unit labor cost-based indicators show a similar improvement in competitiveness, as average wages are generally low in nominal terms. The government's recent unexpected decision to double the minimum wage is not expected to substantially erode these gains (Box 1). Still, risks to external stability remain high in light of balance sheet considerations and Ukraine's vulnerability to commodity price shocks.

C. Outlook and Risks

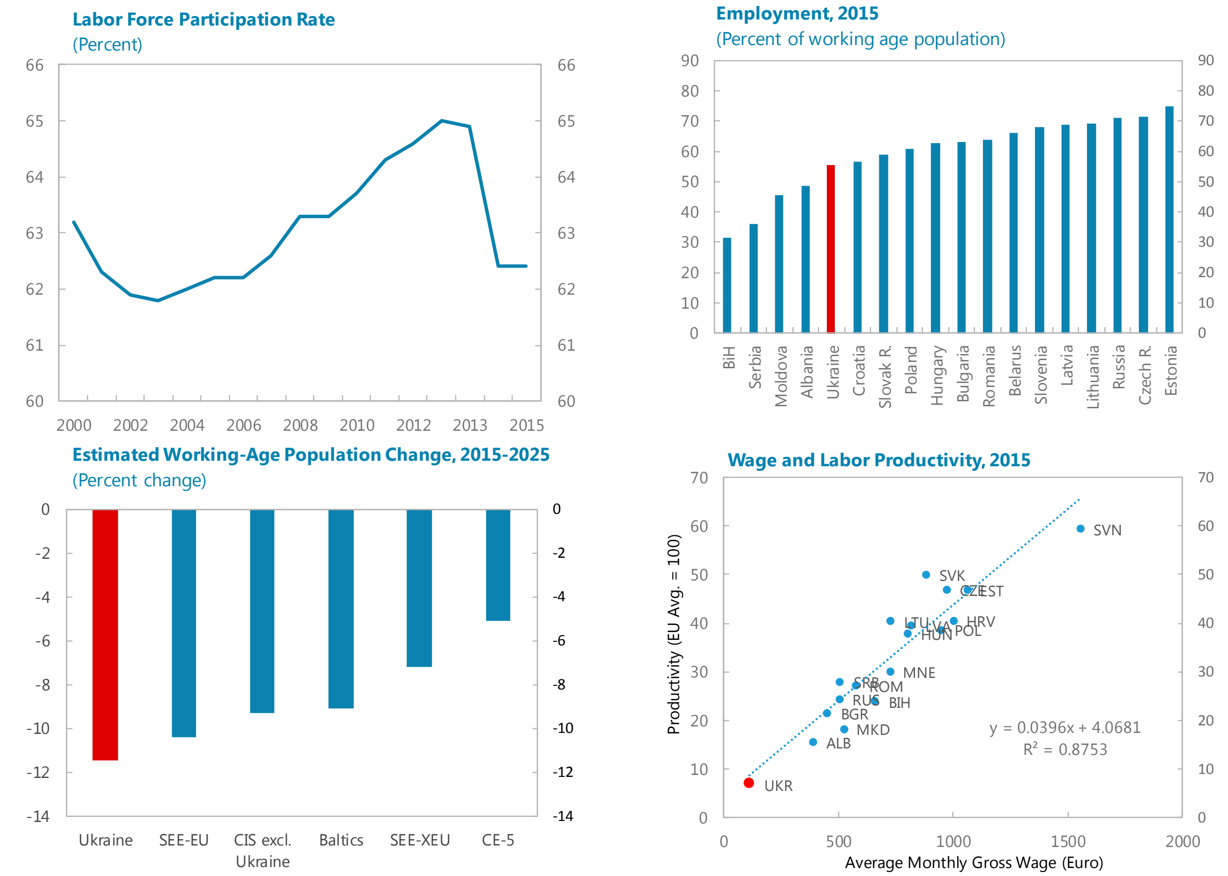
13. The strength and durability of the recovery depend critically upon the pace and depth of structural reforms in the coming years. Rapid and more inclusive growth of at least 4 percent will be needed over the medium term to recover the lost ground and noticeably improve incomes. Even then, it would take more than a generation for Ukraine to catch up with its regional peers.

Figure 2. Ukraine: Selected Structural Indicators 1/



1/ Multiple indicators have been included to mitigate shortcomings of individual indicators, as some are survey based and reflect perceptions.
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/ Score indicates the perceived level of public-sector corruption. A high score corresponds to high perception of corruption. Regional groupings are calculated as the simple average of all countries in the region.
4/ 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.
Sources: European Bank for Reconstruction and Development, World Bank *Doing Business Indicators*, Transparency International *Corruption Perceptions Index* and World Bank *World Governance Indicators*.

Figure 3. Ukraine: Selected Labor Market Indicators

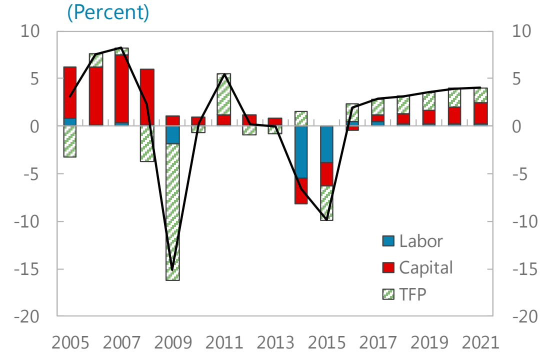


Sources: United Nations *World Population Prospects*, Haver, WEO, State Statistics Service of Ukraine and IMF staff calculations.

14. The improvements in macroeconomic conditions provide sufficient momentum for the economic rebound to continue this year. Growth could accelerate to close to 3 percent in 2017, supported by stronger consumer and investor confidence, and rising real incomes, including due to the higher minimum wage. Inflation is projected to decline further, to close to 10 percent by end-2017, somewhat higher than projected earlier reflecting the impact of the higher minimum wage.

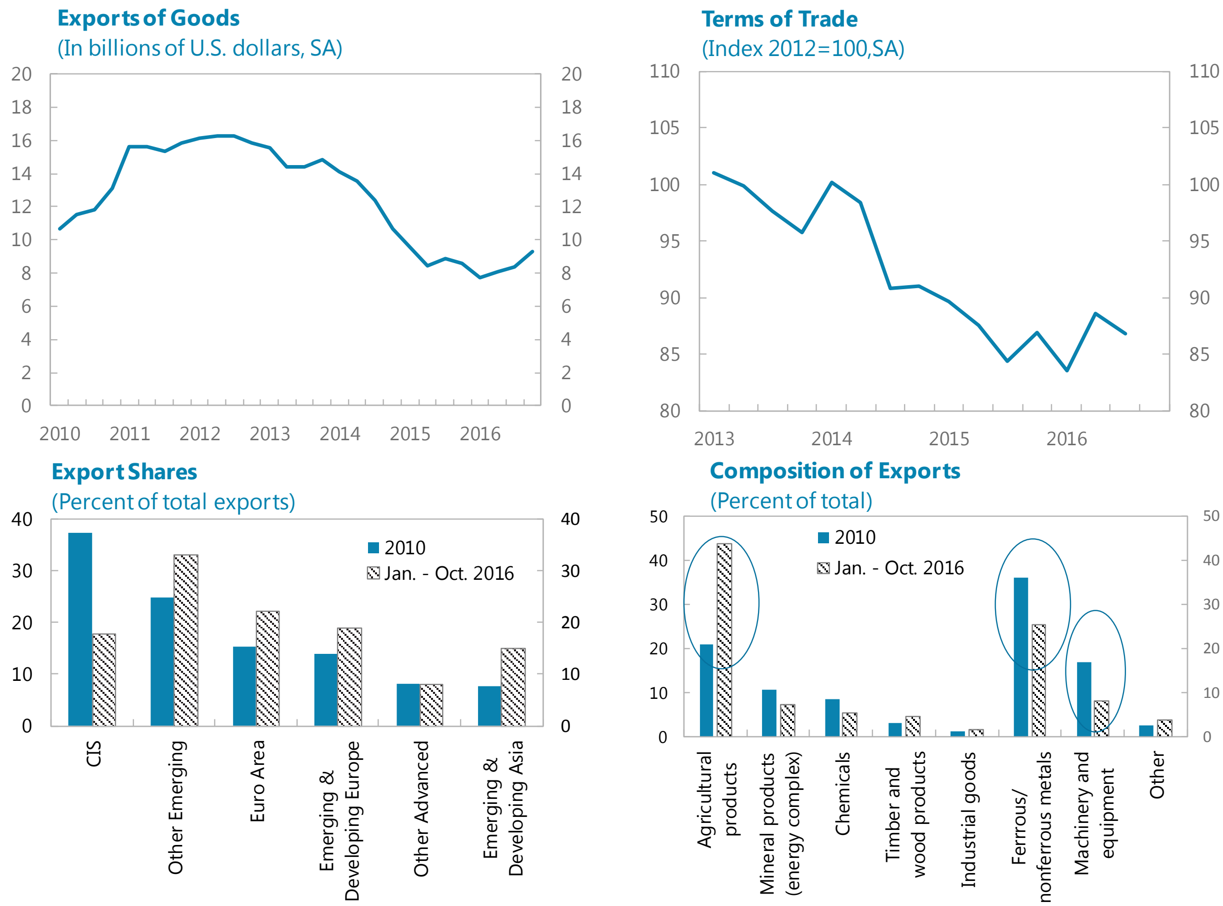
15. Growth could accelerate to around 3½–4 percent over the medium term, assuming that the structural reforms are implemented in line with the program and there is no intensification of the conflict in the eastern part of the country. Medium-term growth is projected to be driven by capital investment to reorient trade and increase production, and a recovery in total factor productivity, driven also by structural reforms and increased labor market participation (with pension reform helping to offset adverse demographic trends).

Real GDP and Contributions
(Percent)



Sources: Authorities and IMF staff calculations.

Figure 4. Ukraine: Selected External Indicators



Sources: National Bank of Ukraine, Haver and IMF staff calculations.

16. Inflation is expected to gradually decline to the NBU's medium-term target of 5 percent in the coming years, as one-off effects subside, monetary policy remains appropriately tight, and confidence strengthens. Reserve adequacy—as measured by the IMF composite index—is expected to be achieved by end-2018.

17. Public debt is projected to drop below 70 percent of GDP by 2021, assuming the successful completion of the debt operation, the fiscal consolidation achieved to date is sustained, and growth gradually picks up. The Debt Sustainability Analysis (DSA) includes the full costs of bank recapitalization of 11½ percent of GDP, assuming successful bail-in of 1¼ percent of GDP of related-party liabilities and, conservatively, no gains from asset recovery (Annex III).

18. The outlook remains subject to substantial risks (Annex IV). A possible escalation of the conflict in the eastern part of Ukraine remains a concern, as recently highlighted by the flare ups of military action and a trade blockade between the government and non-government controlled territories. In addition, the main risks on the domestic side stem from reform delays due to the narrow majority of the governing coalition in parliament and possible policy reversals as key reforms face strong pushback from vested interests. On the external side, key risks include a further weakening of the terms of trade and a weaker global recovery, particularly a slowdown in major emerging markets that could affect Ukraine through trade and commodity price channels. Absent sustained reform implementation or if external risks materialize, growth prospects could be much weaker than projected, with implications for fiscal and external sustainability.

Macroeconomic Framework

(Percent change, unless otherwise indicated)

	2016	2017	2018	2019	2020	2021
Real GDP	2.0	2.9	3.1	3.5	4.0	4.0
Inflation (eop)	12.4	10.0	7.0	6.0	5.0	5.0
General government balance 1/	-2.3	-3.1	-2.6	-2.4	-2.2	-2.1
Public debt 1/	84.9	91.4	86.2	78.6	72.2	66.4
Credit to the nongovernment	-1.1	7.4	8.5	11.4	10.2	10.5
External current account 1/	-3.8	-3.0	-2.6	-2.7	-2.6	-2.9
Foreign direct investment 1/	3.8	1.7	2.5	3.2	3.6	3.4
GIR (eop, billions of U.S. dollars)	15.5	22.3	30.2	30.3	30.7	31.8
Months of next year's imports	3.5	4.7	5.9	5.5	5.2	5.0
Percent of IMF composite measures	62.2	83.9	105.3	102.7	102.0	102.9

Sources: Ukrainian authorities; and IMF staff estimates.

1/ Percent of GDP.

Box 1. Macroeconomic Impact of Doubling the Minimum Wage

The government doubled the minimum wage to UAH 3,200 (about US$125) per month, effective January 1, 2017, with the objective to reduce the size of the shadow economy, estimated at around 40 percent of the overall economy. The economy-wide impact of this measure should be manageable in the short term. However, medium-term fiscal risks stemming from the increase loom large (see paragraph 23).

Ukraine's new minimum wage more than restores its recent erosion in real terms. The new minimum wage is 50 percent higher than its pre-crisis average in real terms—although still lower in U.S. dollar terms. However, at close to 50 percent as a share of the average wage, it is considerably above the 40 percent typically observed in the region. Also, the minimum wage adjusted for productivity is now at the top end of the spectrum among peers.

The authorities' primary objective was to reduce the extensive underreporting of wages in the private sector, and increase the revenue to the pension fund from social security contributions. Official statistics show that about 44 percent of private sector employees receive less than UAH 3,200. However, there is a shared view among policy makers, labor unions, and employers that a large share of actual wages in the private sector are already above the new minimum wage, including at the lower end of their pay structures, as a significant share of workers receive under-the-table wage supplements.

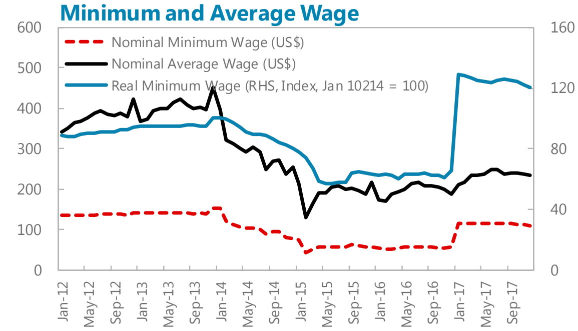
However, the increase in the minimum wage is expected to affect smaller businesses in some of the less populated regions, and could further increase informality. In these areas, the total (official plus informal) lower-end wages are in the UAH 2,000–2,500 range. The new higher minimum wage may drive some of these companies out of business or into the shadow economy, including by shifting employees to part-time contracts and adjusting the number of reported hours to limit their payroll tax. Already, about one-third of employees are part-time workers or self-employed, which is countenanced by the overly generous simplified tax regime for small businesses and a moratorium on tax and labor inspections of small businesses.

Box 1. Macroeconomic Impact of Doubling the Minimum Wage (concluded)

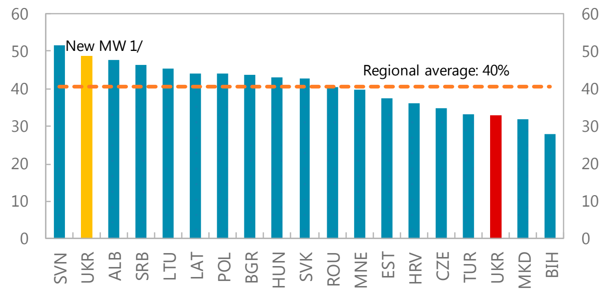
Overall, the new minimum wage is expected to increase growth and inflation in the short term. The increase in the economy-wide (public and private sectors) actual wage bill is expected at roughly 10 percent. This will further increase consumption (and temporarily growth by an estimated modest 0.2 percentage points), and increase inflation by about 2 percentage points in 2017. This assumes that some firms will be able to pass the higher costs to prices, while others will cut down on the number of workers (or hours) and lower investment to offset the higher labor costs and social security contributions. Finally, the impact on the current account is expected to be limited, given the significant domestic component in the consumption basket of low-income earners.

The longer-term impact will depend on whether the central bank allows the exchange rate to adjust and the increase is perceived as a one-off. If the expectation is that the wage increases will be repeated in following years, inflation expectations will increase and central bank action to rein them back in would slow lending and investment. The long-term impact will also depend how the increase will feed through to public sector wages and pensions in the coming years.

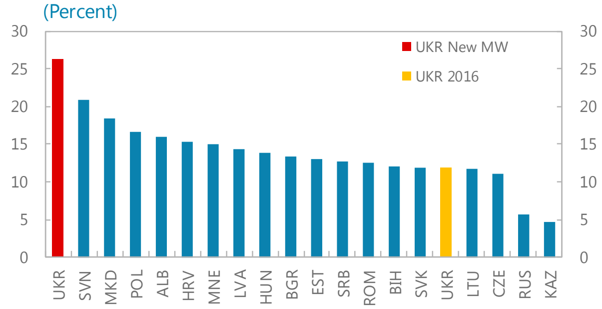
Minimum and Average Wage



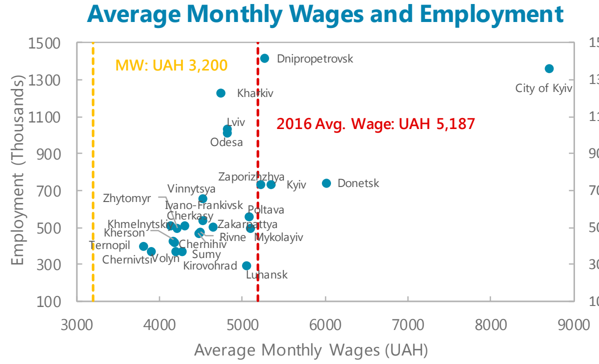
Minimum Wage
(Percent of average wage, 2015)



Productivity-Adjusted Minimum Wage
(Percent)



Average Monthly Wages and Employment



Sources: World Economic Outlook; Haver Analytics; Ukrainian authorities; and IMF staff calculations.
1/ IMF staff projection for average wages in 2017.

ARTICLE IV POLICY DISCUSSIONS: ACHIEVING FASTER AND SUSTAINABLE GROWTH

19. **An ambitious policy agenda is necessary to accelerate growth and improve living standards, while strengthening resilience and maintaining macroeconomic stability**. Policies should continue to focus on: (i) building a vibrant private sector and raise the economy's potential, by accelerating efforts to reform the large SOE sector, improve the business environment, develop a

market for agricultural land, and tackle corruption; (ii) ensuring fiscal sustainability, through further consolidation, supported by pension reform, improving spending efficiency, and making the tax system more efficient and growth friendly; (iii) further energy reforms to improve governance and efficiency, while avoiding a reemergence of quasi-fiscal deficits; (iv) further reducing inflation and rebuilding reserves; and (v) repairing viable banks and reviving sound bank lending.

A. Building a Vibrant Private Sector

20. The pace of structural reforms will need to be dramatically increased to improve the business environment, attract investment, and raise the economy's potential:

- To build momentum in what to date has been a largely unsuccessful privatization process, a first set of larger companies will need to be privatized in a transparent process and a pipeline of companies for sale will need to be prepared, with their shares transferred from the line ministries to the State Property Fund. A much faster divestiture of smaller companies and assets of defunct companies should be facilitated by launching an electronic platform. Only a small number of SOEs considered strategic should remain under state ownership, with further improvements in their governance, including the appointment of independent supervisory boards.
- As Ukraine has a comparative advantage in agriculture and related industries, land reform will need to get underway. The key step toward this would be adopting legislation to allow the sale of agricultural land and lifting the moratorium on land sales.
- A much broader improvement of the business environment is also needed. This would include further efforts to eliminate unnecessary licenses, improve revenue administration, advance judicial reform and ensure adherence to the rule of law, and strengthen competition. Also, reducing rigidities in the labor code should foster employment.

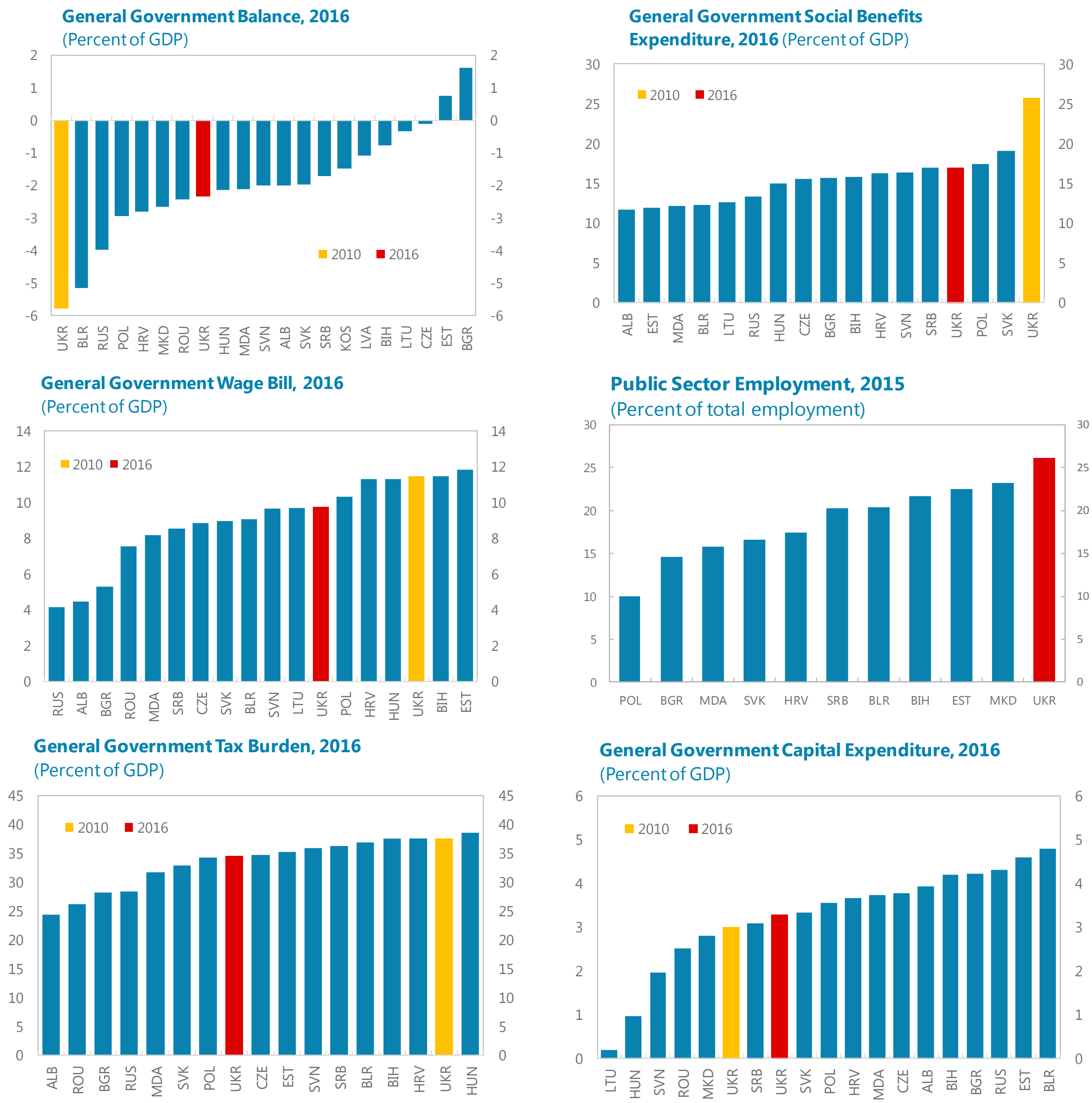
21. Most of all, decisive steps need to be taken to tackle corruption and increase transparency. Corruption remains the most frequently mentioned obstacle to doing business in Ukraine.[1] While there has been progress in setting up new institutions, including the National Anti-Corruption Bureau of Ukraine (NABU), and the adoption of legislation to reform the judiciary and the declaration of assets by high-level officials were major steps forward, tangible results in prosecuting and convicting corrupt high-level officials and recovering proceeds from corruption have yet to be achieved. To help with this: (i) the National Agency for the Prevention of Corruption (NAPC) should start checking the asset declarations of senior officials and be more forthcoming in working together with NABU; (ii) NABU's investigative powers should be strengthened further; and (iii) an independent anticorruption court should be set up. Increased scrutiny of high-level officials' sources of wealth and further strengthening the anti-money laundering framework will help detect and deter corruption. Moreover, public administration reform is necessary to create room to decompress the wage structure, to ensure a better link between a person's wage and the job performed, and reduce incentives for corruption.

[1] Staff analysis suggests that a lower level of corruption, at the EU average, could contribute to a higher rate of per capita GDP growth, by possibly as much as 2 percentage points a year (see Selected Issues Paper from March 2017).

B. Making Government Finances Sustainable and More Efficient

22. With public debt still above safe levels, continued fiscal discipline is necessary to ensure that debt remains on a steady downward path. In particular, a primary fiscal surplus of at least 1¾ percent of GDP needs to be sustained in the coming years to steadily reduce debt. Staff projections suggest that debt would fall below 70 percent of GDP by 2021 (Figure 5).

Figure 5. Ukraine: Key Fiscal Indicators



Sources: IMF Government Compensation and Employment Dataset, 2016; Ukrainian authorities; IMF World Economic Outlook; and IMF staff calculations.

23. In this regard, substantial fiscal pressures will need to be overcome. The decision to double the minimum wage has increased risks to medium-term fiscal sustainability. Despite the authorities' efforts to limit the immediate impact on the wage bill to 1½ percent of GDP by compressing the wage structure, strong pressures could emerge to raise civil service wages and pensions.[2] In particular, under a scenario that assumes implementation of the civil service law adopted last year—which prescribes a series of increases in base wages—and a gradual increase in pension replacement rates to pre-crisis levels, fiscal measures in the order of 3–5 percent of GDP would be needed to ensure the program's medium-term primary balance target of 1¾ percent of GDP is achieved.

24. Structural fiscal reforms are therefore critical to achieve the fiscal targets. With defense spending likely to stay elevated and the need to increase public investment to support the reconstruction and growth objectives, it will be critical to advance reforms to: (i) downsize public sector employment—which at 25 percent of total employment is large compared to elsewhere in the region—including notably in the healthcare and education sectors, while improving the efficiency of spending; (ii) streamline social assistance programs and improve their targeting to protect the vulnerable; and (iii) ensure the viability of the pension system.

25. Ukraine's pension system needs to be placed on a sound financial footing, including to create space for better pensions in the future (Figure 6). Ukraine has one of the highest levels of pension spending in Europe, while having one of the lowest levels of average pension benefits, providing an old-age income of slightly more than US$2 per day. This is the result of a very large number of beneficiaries—with a beneficiary to contributor ratio of 1:1—reflecting one of the lowest statutory retirement ages in Europe combined with still generous early retirement options. Pension fund revenues are also low, as the social contribution rate was cut to one of the lowest in Europe in late 2015, and there is considerable avoidance in paying contributions. This has resulted in the second largest pension fund deficit in Europe, estimated to have reached 6 percent of GDP in 2016. The challenges are expected to only worsen in the coming years, as the population continues to age and young people leave to find job opportunities abroad. While some steps have been taken by reducing privileged pensions, the long-delayed overhaul of the pension system is urgently needed to restore its viability. Comprehensive reforms should focus on further reducing the scope for early retirement, increasing years-of-service requirements and creating incentives for people to pay contributions and retire at a later retirement age. As the impact of these decisions on the pension system's finances will be gradual, it is crucial to act now.

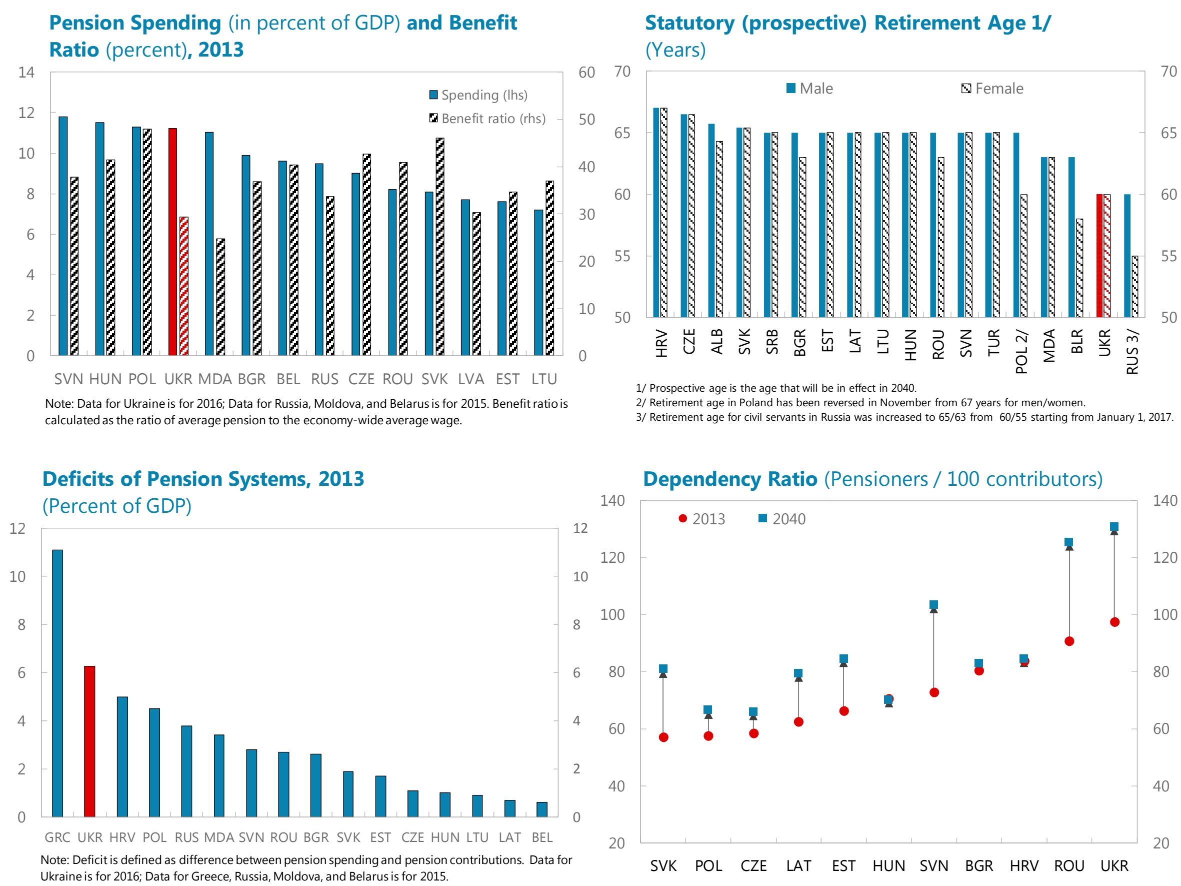
26. Further major tax cuts should be avoided. After the tax reforms adopted in late 2015, tax rates are no longer high by international standards. Bringing the agricultural sector fully under the general regime for value added taxation was a major step forward. However, support for reducing the base for corporate income taxation still remains strong, but this would lead to substantial

[2] To contain the impact on the deficit, legislation was adopted to delink the wage grid in the civil service and the judiciary from the minimum wage, further compressing the wage structure. Moreover, the minimum subsistence level—which until now had been equal to the minimum wage—was not raised to avoid any impact on pensions.

revenue losses. Similarly, proposals for tax amnesties, the introduction of tax holidays and tax-free industrial zones would distort the tax system with, at best, dubious results, and should be resisted.

27. Efforts should instead focus on tightening the overly generous simplified tax regime and improving revenue administration. The effective taxation rate under the simplified tax regime for small taxpayers needs to be increased significantly and eligibility tightened to reduce opportunities for tax avoidance and improve equity. The overhaul of the revenue administration must move ahead without further delays to transform the State Fiscal Service (SFS) into a modern administration, including by strengthening its institutional framework, its powers to collect and enforce taxes, but also its governance. Given the still very large size of the informal economy, there would be significant potential for revenue gains to fund government priorities.

Figure 6. Ukraine: Pension System Challenges



Sources: The 2015 Aging Report, Ukrainian authorities, European Commission, and IMF staff estimates.

C. Improving Energy Efficiency and Independence

28. Keeping energy prices at import-parity levels is critical to prevent the reemergence of quasi-fiscal deficits. Following two rounds of tariff adjustment, gas and heating tariffs reached full import parity levels after the 2015–16 heating season, supporting a dramatic decline in gas consumption and all but eliminating the quasi-fiscal deficit of Naftogaz in 2016. While a law providing for an independent regulator was adopted, there has been limited progress in unbundling the gas sector. Pending the full liberalization of the gas market, it will be important to ensure that tariffs remain at full cost recovery.

29. The poorest households should continue to be protected from higher energy tariffs, but the targeting of subsidies needs to be improved. The impact of the higher tariffs on the population has been mitigated by utility subsidies that are provided now to half of all households. These subsidies need to be better targeted to keep them fiscally affordable, while protecting households in need, and focus on incentivizing energy efficiency.

30. Structural reforms—including further improvements in governance and regulation—will need to continue to attract investment in domestic oil and gas production and increase energy independence and efficiency. Energy inefficiency is still high, providing scope to further reduce the burden of the energy sector on the economy (Box 2). The increase in the price of domestically-produced gas and the adoption of legislation to establish an independent energy regulator have been important steps to help attract investment in domestic gas production and reduce import dependency, as have been improvements in the governance of Naftogaz. Further steps include the unbundling of Naftogaz and the monetization of utility subsidies so that private gas traders can compete with Naftogaz in the supply of gas.

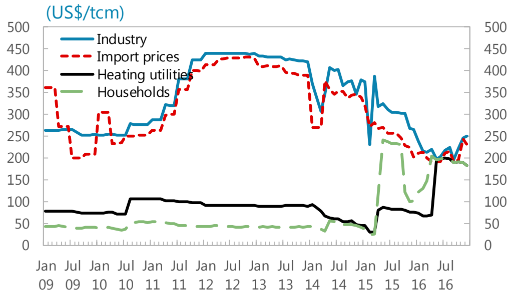
D. Rebuilding Reserve Buffers and Anchoring Inflation at Low Single Digits

31. Continued strong support for central bank independence remains important for the NBU to deliver on its efforts to rebuild reserves and secure low and stable inflation. The NBU is targeting a gradual disinflation path, with a commitment to continue to adhere to a flexible exchange rate regime that will support the required economic adjustment.

Box 2. Energy Efficiency

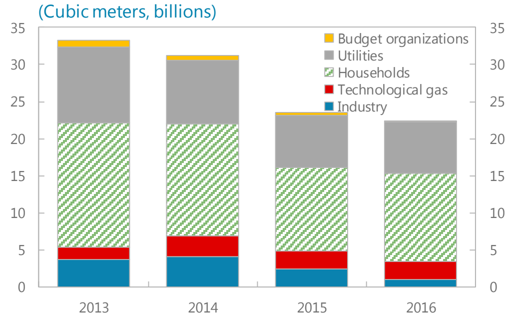
Improving energy efficiency in Ukraine is one of the key elements to reduce the external and fiscal burden of the energy sector. Until recently, very low tariffs for residential gas and district heating encouraged excessive energy consumption and led to large quasi-fiscal losses, pushed up gas imports, and discouraged investment in domestic production.[1] The large tariff increases to full cost recovery have provided incentives to conserve energy and supported an improvement in energy efficiency and a dramatic decline in household gas consumption and corresponding reduction in macro imbalances.

Import Prices and Gas Tariffs
(US$/tcm)



Sources: Naftogaz and IMF staff calculations.
Note: Tariffs net of transit fees, transportation costs and VAT.

Gas Demand by Consumer Type
(Cubic meters, billions)



Source: Naftogaz.

[1] Gas represents about 75 percent of resources used for individual heating.

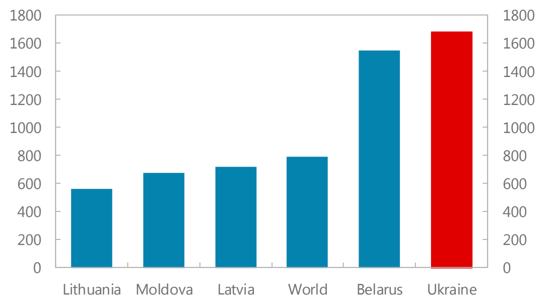
Box 2. Energy Efficiency (concluded)

Energy-related social assistance programs can be improved to increase incentives to conserve energy. Around half of households are receiving subsidies to help defray the cost of higher gas and heating tariffs, which accrue as a non-cash credit on households' utility accounts. Fearing the loss of these credits, households have less incentive to reduce energy use. Monetization of these credits at the household level could help incentivize households to further reduce consumption. In this regard, the government and the EU are leading an initiative to assist households to invest in meters, regulators, insulation and other modernization measures, which would, in turn, reduce the need for subsidies.

There is also scope to improve the technological efficiency of district heating companies. Outdated infrastructure results in large energy losses in the production and transportation of heat, and heating companies often have difficulty in securing financing for their investment programs. To improve the efficiency of the district heating system, as part of the Fund-supported program, the energy regulator has introduced incentives to reduce thermal energy losses in the process of its delivery via heat distribution networks. Specifically, provided the company increases infrastructure investments and reduces losses over time, the mechanism allows for the costs of actual energy losses to be reflected in heating tariffs. In addition, the government, with assistance from the EBRD, has put together a working group to examine energy efficiency reform in the district heating sector.

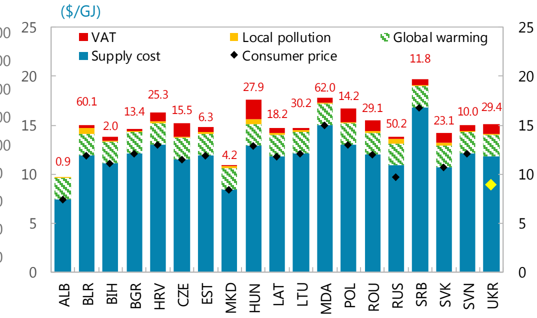
Although gas and heating tariffs now reflect supply costs, they do not reflect environmental externalities. Research by the Fund's Fiscal Affairs Department suggests that an environmentally efficient tariff would be some 20 percent higher. This would internalize both the negative health effects of local pollution and the costs of the contribution of local emissions to global warming.

CO2 Emissions in Residential Heat and Electricity Sectors, 2013 (kg per capita)



Source: IEA.

Environmentally Efficient Natural Gas Pricing, 2013 ($/GJ)



Source: IMF staff calculations.

- Gross international reserves have increased to US$15 billion (about 60 percent of the ARA metric), but they are still relatively low compared to what is needed to provide an adequate buffer and handle the large external debt service payments falling due after 2018. As further progress is made in strengthening reserves and entrenching financial stability, consideration should be given to easing remaining administrative measures on foreign exchange, giving priority to measures that help to improve business conditions, attract investment, and deepen the foreign exchange market.

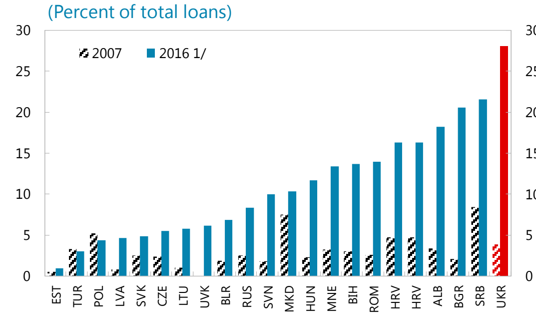
- The NBU should continue to refine its inflation-targeting framework, including by strengthening credibility and enhancing the transmission mechanism, by further improving its operations, analytics, and communication, as well as further steps to support financial sector development.

E. Safeguarding a Stable Financial System that can Support Growth

32. While impressive progress has been made in restoring banks' financial health and improving governance, there remain significant challenges to fully securing financial stability. This includes ensuring that banks are adequately capitalized, are reducing related-party exposures to below prudential limits, and have a transparent ownership structure. Recapitalization plans and plans for unwinding related-party exposures have already been adopted for the largest banks, accounting for some 95 percent of current banking system assets, and these banks have now reached a risk-weighted capital of at least zero, including the largest bank, PrivatBank, following its nationalization. Banks that fail to meet the requirements of these plans should continue to be resolved promptly, and all efforts should be made to maximize the asset recovery and in a timely manner of resolved banks, thereby limiting the costs to the state. Over the last two years, the NBU closed 88 banks—accounting for more than half of the banking system's assets in early 2014. Banking supervision and governance need to be strengthened further, including to avoid a renewed buildup of loan concentration risks. State-owned banks will need to operate on a commercial basis and improve their governance to prepare them for eventual privatization.

33. Stronger efforts will be needed to address the high level of non-performing loans (NPLs) to facilitate new sound lending to the economy. The high level of NPLs reflects the inability to foreclose on assets and the lack of incentives to restructure NPLs. To this end, the legal framework for corporate insolvency needs to be strengthened, newly adopted arrangements for out-of-court restructuring of corporate debt need to be implemented, tax disincentives to restructuring should be addressed, and the debt collection enforcement regime improved. Stronger efforts will also be needed to maximize the recovery of assets of failed banks by the Deposit Guarantee Fund (DGF) and facilitate their sale in a more efficient and transparent manner.

Non Performing Loans
(Percent of total loans)



Sources: World Bank WDI and IMF staff calculations.
1/ Or latest available.

F. The Authorities' Views

34. The authorities agreed on the need to continue with an ambitious set of policies under the program to accelerate growth and reduce remaining vulnerabilities. They agreed with the external assessment, notably that the exchange rate was broadly in line with fundamentals and that competitiveness had been restored. They acknowledged that faster progress was needed to advance the transition to a modern market economy, including by improving the business environment and tackling corruption. They noted that they intend to focus their efforts on revamping the sale or restructuring of SOEs and strengthening the judiciary in line with the reform legislation adopted in June 2016. They also underscored that they remain committed to maintaining sound fiscal and monetary policies, and advancing structural fiscal reforms to improve the efficiency of government spending. They pointed to the start they had made with the reform of the large education and health sectors, as well as with the development of a proposal for pension reform aimed at substantially reducing the pension system's deficit. The authorities saw the program as an important framework and anchor for their policies and have outlined their intentions in greater detail in the attached Letter of Intent and Memorandum of Economic and Financial Policies (MEFP).

35. At the same time, the authorities pointed to the substantial challenges they faced, not least the continuing conflict in the eastern part of the country. They stressed the challenges in passing some reform legislation through parliament, given the small majority of the coalition in parliament. The authorities noted that notwithstanding these challenges, considerable progress had been made in reducing imbalances and restoring growth against a difficult external environment.

PROGRAM DISCUSSIONS: ACCELERATING THE REFORM MOMENTUM

36. Program discussions focused on accelerating the reform momentum in key policy areas to keep the program on track. Macroeconomic policies remained on track, over-performing in many areas. All continuous and end-December 2016 performance criteria—which have become the controlling criteria with the delay in the completion of this review—were met. The authorities' reform efforts have been mainly focused on achieving progress in ensuring fiscal sustainability and financial stability, and efforts to enhance transparency. They implemented ***five prior actions*** for the completion of this review:

- Adopting a 2017 government budget consistent with program targets, including the necessary supporting legislation;
- Securing progress made in bringing gas and heating tariffs to import-parity levels by adopting an automatic tariff adjustment mechanism;
- Reducing consumption norms for utility subsidies;
- Resolving banks that failed to meet capital requirements in line with agreed timetables, including the nationalization of the largest private bank; and
- Ensuring that all high-level officials submitted an electronic asset declaration and making these available to the public.

As these measures posed considerable political and technical challenges, and taking into account limitations of the authorities' implementation capacity, 8 out of 11 structural benchmarks for this review had to be reset.

A. Fiscal Policy

37. Budget execution continued to be strong, over-performing relative to program targets. The 2016 budget deficit has been limited to 2.3 percent of GDP, compared to a target of 3.7 percent of GDP. The over-performance was the result of stronger tax and non-tax revenues.

38. Parliament approved a 2017 government budget consistent with the deficit target of 3.1 percent of GDP (MEFP ¶18). Tax rates were kept mostly unchanged, with the exception of some increases in excise rates. Importantly, the agricultural sector is now fully under the general regime for VAT. Wages in the broader public administration—including teachers and healthcare workers—were raised in line with the higher minimum wage, but the wage grids for the civil service and the judiciary were decoupled from the minimum wage, as the lowest wages in these sectors—taking into account allowances and bonuses—were already higher than the new minimum wage. The authorities recognized that pressures to raise civil service wages as well as pensions are likely to increase, increasing the need to accelerate structural fiscal reforms, including civil service, pension, healthcare, and education reforms, to eliminate waste and improve outcomes (MEFP ¶21).

39. The authorities have started developing a comprehensive pension reform package, but more time is needed to prepare legislation and obtain parliamentary approval (MEFP ¶21a). Pension reform has proven to be a challenging and much-delayed area of reform, but given the increased urgency, the authorities are preparing new pension legislation, with assistance also from the World Bank, aiming to obtain parliamentary approval by end-April 2017 (a new date for this missed ***structural benchmark***). This reform will aim to put pension fund finances on a sustainable footing and create room for better pensions by increasing the effective retirement age. In addition, to help detect benefit fraud, they will establish a single database of beneficiaries of social benefits, including pensions (a new ***structural benchmark*** for end-December 2017, MEFP ¶21d).

40. Some progress was made in improving revenue administration. The SFS has substantially reduced its staff and streamlined the number of regional offices, and has begun the reorganization of its operations along functional lines. It has also stepped up anticorruption efforts by starting the process of vetting and reappointing staff, and establishing a new internal department to investigate corruption-related offenses by SFS staff. The ministry of finance established key performance indicators for the SFS, which should help with an objective assessment of reform progress. Taxpayer services have been improved by concentrating large taxpayers in the Large Taxpayer Office, as well as by launching new electronic services—streamlining especially the process for VAT payments and refunds—and introducing a "single window" at customs.

41. More remains to be done, however, to create an efficient and modern revenue administration (MEFP ¶20). To this end, the authorities will merge tax and customs administrations within the SFS, transform the SFS into a single legal entity by end-March 2017 (a new deadline for this missed ***structural benchmark)***, and complete the reorganization along functional lines. Other immediate priorities include establishing stronger oversight by the ministry of finance of SFS operations, including its IT systems, dissolving the tax police within the SFS and establishing a new civil financial police (a new ***structural benchmark*** for end-April 2017), strengthening taxpayer compliance by granting SFS additional legal powers (e.g., and the ability to use indirect tax liability assessment methods), and introducing risk-based audit procedures.

B. Energy Sector Policies

42. The authorities have taken steps to safeguard progress in the energy sector. An automatic tariff adjustment mechanism has been put in place, adjusting gas tariffs semi-annually to ensure that they remain at import parity (MEFP ¶24), to avoid a reemergence of losses until the full liberalization of gas tariffs is realized, as envisaged in the gas market law adopted in 2015. To facilitate the liberalization of tariffs and promote competition in the gas market, utility subsidies will be monetized (at the level of utility companies) before the next heating season (a new ***structural benchmark*** for end-August 2017).

43. The authorities will also ensure that household utility subsidies are better targeted and fiscally affordable (MEFP ¶23). Consumption norms have been revised downward to better reflect declining consumption. Additional changes that will be introduced before the next heating season include further adjustments to the household utility subsidy parameters to improve targeting, an adjustment to the social norm for off-peak heating months to better match seasonal consumption patterns and the introduction of a capacity-based distribution tariff that would shift some of the utility charges to the summer, thus reducing the need for subsidies during the heating season (a new ***structural benchmark*** for end-July 2017).

C. Monetary and Exchange Rate Policies

44. The NBU will continue its policy of gradually reducing interest rates, purchasing foreign exchange, and following a conditions-based easing of administrative measures (MEFP ¶3–6). The new NBU council approved the monetary policy guidelines for 2017 and the medium term, which target a further reduction in inflation to 8 percent by end-2017 (±2 percent) and 5 percent over the medium term, within a flexible exchange rate regime. In line with this, the key policy rate has been kept positive in real terms (14 percent since October 2016), and the NBU agreed that any further easing of the monetary policy stance will need to be gradual and conditional on inflation expectations and reserve accumulation. The NBU also continued to purchase foreign exchange—meeting the September and December 2016 net international reserve targets—with occasional sales of foreign exchange when needed to avoid excessive volatility.[3] It has developed a new condition-based road map, with the assistance of Fund staff, for the further relaxation of administrative measures on foreign exchange, giving priority to measures that support investment and a deepening of the foreign exchange market.

[3] The lower gross reserves for end-2016 and 2017 compared to the second review projections are explained by the timing of IFI disbursements and the gradual start of dividend repatriation (allowed since June 2016), aimed at improving business confidence and attracting foreign investment.

D. Financial Sector Policies

45. The authorities nationalized the largest bank, after several deadlines were missed and it became clear that it was unable to meet capital requirements (MEFP ¶8). While other banks out of the group of 20 largest banks brought their capital adequacy ratio to at least 5 percent of risk-weighted assets—taking into account also a new credit risk regulation—PrivatBank was unable to do so. The authorities decided to nationalize the bank in light of its systemic role in Ukraine's financial system, accounting for more than one-fifth of banking system assets, and financial stability concerns. The capital shortfall, amounting to nearly 7 percent of GDP, stemmed mainly from loans to related parties that needed to be provisioned for, given the absence of adequate collateral or credible underlying cash flows. With the nationalization, the state became the sole owner of the bank, and the authorities have bailed in related-party deposits and other liabilities equivalent to about 1¼ percent of GDP (12 percent of the bank's total deposits and liabilities). All other household deposits have been fully guaranteed.

46. It is now crucial that the nationalization is followed by firm and transparent efforts to collect on related-party loans, to minimize the cost to the state and taxpayers. New management and supervisory boards have been appointed, the latter with a majority of independent members. A reputable audit firm was hired to perform a due diligence of the bank's financial position. Moreover, a forensic audit will be conducted to help the authorities with their investigation of possible wrongdoing ahead of its nationalization. To mitigate the risks stemming from any delay in asset recovery, the loans to parties related to the former owners have been assigned to a special unit in the bank. An international asset management firm will be hired to enhance the value of, or to collect on, these loans, and another reputable audit firm will be hired to evaluate progress in enhancing this loan portfolio (a ***new structural benchmark*** for end-April 2017). It will be crucial for the authorities to pursue all available legal and commercial means in line with international best practice to maximize recovery of loans. Over the medium term, PrivatBank should be privatized.

47. The NBU will continue its efforts to improve the health of the remaining banks (MEFP ¶8). The next group of 19 largest banks had been required to bring their capital to at least zero by mid-January 2017 and to submit credible plans for their further recapitalization and unwinding of related-party exposures. Three banks were unable to meet this deadline and were closed and transferred to the DGF. The remaining banks in this group will need to achieve a capital adequacy ratio of 5 percent by end-April 2017. The remaining 59 banks, accounting for about 5 percent of banking system assets, will be similarly evaluated during 2017.

48. Further efforts will be undertaken to strengthen financial sector oversight and governance (MEFP ¶11–16). Legislation to improve the governance of state-owned banks is expected to be adopted by end-March 2017. This will establish smaller and independent supervisory boards at these banks and transfer the accountability for these banks' performance from the cabinet to the supervisory and management boards. The authorities have already hired an international recruitment firm to run the selection process for the independent members of the supervisory boards. Other legislation that is expected to be approved in the coming months will allow for the establishment of a credit registry at the NBU; enhance the DGF's ability to dispose of assets from failed banks; and strengthen the corporate debt restructuring and insolvency framework (a missed ***structural benchmark***, reset for end-September 2017). The NBU will also complete the assessment of its regulatory framework in the coming months.

49. Further progress was made in strengthening the NBU's institutional framework in line with the recommendations of the last safeguards assessment. Following the enactment of amendments to the NBU Law in 2015, a new Council was established in November 2016 and is currently operational. The Council constituted an Audit Committee to provide independent oversight on audit mechanisms and internal controls (MEFP ¶7). The NBU also revamped its emergency liquidity assistance framework in line with Fund staff recommendations.

E. Structural Reforms

50. The publication of senior officials' asset declarations was a major step forward, but more will be needed to deliver concrete results in addressing corruption (MEFP ¶26). The large amounts disclosed by some senior officials was a source of surprise for the population. Adequate follow up, starting with non-filers, should be prioritized as the current lack of concrete results in addressing corruption is a source of growing discontent and deters investment. To this end, the authorities will further strengthen the powers and independence of NABU, including by giving it the right to wiretap (a missed ***structural benchmark***, reset for end-May 2017), and by safeguarding its exclusive jurisdiction for high-level corruption cases. Moreover, they will also set up an anticorruption court as foreseen in the June 2016 Law on the Judiciary (passage of implementing legislation is a new ***structural benchmark*** for mid-June 2017) that is to become operational in early 2018, and will further strengthen the anti-money laundering framework.

51. With little progress made in SOE reform and improving the business environment, benchmarks had to be reset (MEFP ¶27–28). A piecemeal approach to these reforms has failed to generate momentum. Privatization of large SOEs is yet to happen, with the failed privatization of the Odessa Portside Plant revealing significant shortcomings in the process. Similarly, significant delays in the completion of the triage of all SOEs (a missed ***structural benchmark***, reset for end-August 2017) have held back progress in the implementation of the authorities' SOE reform strategy. The authorities aim to accelerate efforts, including by: (i) identifying a pipeline of large enterprises for privatization, with parallel privatization processes; (ii) accelerating the liquidation of non-viable companies and the streamlined privatization of smaller companies through electronic auctions; (iii) appointing independent supervisory boards in all large SOEs under transparent procedures to strengthen oversight of the ones that remain under the state; and (iv) improving the legal framework, including the adoption of amendments to the privatization law to improve transparency and safeguards (a missed ***structural benchmark***, reset for end-August 2017). The elimination of costly regulations and adoption of the law on the electricity market remain a priority, as is the adoption of a law on agricultural land circulation (a missed ***structural benchmark***, modified and reset for end-May 2017) that will allow for the removal of the moratorium on land sales. Finally, putting in place an efficient regime for the expedited processing of claims and enforcement of debts through seizure of sums in bank accounts (a missed ***structural benchmark***, reset for end-September 2017) will be key to strengthening payment discipline.

PROGRAM FINANCING AND MODALITIES

A. Program Financing

Financing assurances

52. **Firm financing assurances are in place for the next 12 months, with good prospects for the rest of the program**. This includes the second and third tranches of the EU's Macro Financial Assistance (each €600 million) expected by Q1-2017 and Q4-2017, respectively. Also, with continued sound economic policy implementation, Ukraine is expected to regain market access in late 2017. It is assumed that the Russian-held bond will be restructured consistent with program parameters. Overall, together with strong program implementation, external financing commitments remain adequate to close the financing gap through the end of the program.

Debt Operations

53. **The authorities' debt restructuring efforts have thus far been consistent with the requirements under the policy on lending into arrears to official bilateral creditors**. The authorities have continued to pursue good-faith efforts. In terms of process, they have offered to meet with the Russian authorities, offering substantive dialogue in a collaborative process to reach an agreement with Russia on the restructuring of the US$3 billion bond.[4] The terms that have been offered by the Ukrainian authorities have been in line with the financing and debt objectives of the program and would not result in financing contributions that exceed the requirements of the program. Further, the terms did not imply a contribution that would be disproportionate relative to other official bilateral creditors. Although current efforts

Program Financing
(In billions of U.S. dollars)

			Projections		
	2015	2016	2017	2018	Total
Financing Gap 1/	15.6	6.3	12.4	5.7	40.0
Reserve accumulation	6.0	2.3	6.8	7.9	23.1
Underlying BOP gap 1/	9.6	4.0	5.7	-2.2	16.9
Identified Financing 2/	15.6	6.3	12.4	5.7	40.0
Bilateral and multilateral	9.8	2.7	8.0	3.7	24.3
IMF	6.5	1.0	5.5	3.8	16.8
Other multilateral/bilateral	3.3	1.7	2.6	-0.1	7.5
Multilateral	1.0	0.3	1.0	-0.1	2.1
European Union	0.9	0.1	1.3	0.0	2.3
United States	1.0	1.0	0.0	0.0	2.0
Other bilateral	0.4	0.3	0.4	0.0	1.1
Debt operation	5.7	3.5	4.4	2.0	15.7
Memorandum items:					
Project loans 3/	0.7	0.9	0.9	1.4	3.9
Multilateral	0.7	0.8	0.5	0.9	3.0
WB	0.1	0.1	0.2	0.5	0.9
EBRD	0.5	0.7	0.3	0.2	1.6
EIB	0.1	0.0	0.1	0.3	0.5
Bilateral	0.0	0.0	0.4	0.5	0.9
Capital market access	0.0	0.0	1.0	2.0	3.0
Gross international reserves	13.3	15.5	22.3	30.2	
Percent of composite metric	51.3	62.2	83.9	105.3	

Source: IMF staff estimates.
1/ Excludes the effect of spending reflected on the current account generated by project loans.
2/ Excludes project loans and currency swaps.
3/ Project financing to the public and private sector.

[4] A hearing on a motion for a summary judgment in the lawsuit filed by Russia in the UK courts took place in January 2017, but the judgment is pending.

have not yet resulted in a negotiated agreement and will need to continue in the coming months, staff assesses that the Ukrainian authorities' efforts have been consistent with the requirements under the policy on non-toleration of arrears to official bilateral creditors. Also, a decision to provide financing despite the arrears is not expected to have an undue negative effect on the Fund's ability to mobilize official financing packages in future cases.[5] Moreover, prompt financial support from the Fund is considered essential for Ukraine to maintain an adequate level of reserves, while it pursues appropriate policies and undertakes critical reforms to support its economy and address balance of payments needs. Thus, in staff's view, the conditions have been met to proceed with the review.

B. Exceptional Access Criteria

54. The program continues to satisfy the substantive criteria for exceptional access (Box 3). While public debt is projected at 72.2 percent of GDP in 2020, slightly above the original program target (71 percent), it will be on a firm downward path, and there is now less uncertainty about the contingent liabilities of the financial system. However, recent delays in structural reforms, notably those that require legislation to be approved by parliament, have provided a better understanding of the speed at which the authorities will be able to implement the program. Overall, continued adherence to the fiscal goals and the passage of a 2017 budget consistent with program targets, the substantial progress in restructuring the financial system, and steps to safeguard the gains in energy sector reforms, in addition to the authorities' commitment to the program, point to sufficient capacity to successfully implement the program.

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.

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 has experienced exceptional balance of payments pressures emanating from both the current and capital accounts, requiring financing well beyond normal limits, despite expected financial support from the international community. Notwithstanding progress achieved over the past year, official reserves remain very low covering only 59 percent of short-term debt and well below the 100 percent adequate benchmark of the Fund reserve metric. A package of capital control measures is still in place to support financial stability.

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. Where the member's debt is assessed to be unsustainable ex ante, exceptional access will only be made available where the financing being provided from sources other than the Fund restores debt sustainability with a high probability. Where the member's debt is considered sustainable but not with a high probability, exceptional access would be justified if financing provided from sources other than the Fund, although it may not restore sustainability with high probability, improves debt*

[5] See also the Staff Report on Ukraine—Second Review Under the Extended Fund Facility and Requests for Waivers on Non-Observance of Performance Criteria, Rephasing of Access and Financing Assurances Review (IMF Country Report No. 16/319).

Box 3. Exceptional Access Criteria (concluded)

sustainability and sufficiently enhances the safeguards of Fund resources. For purposes of this criterion, financing provided from sources other than the Fund may include, inter alia, financing obtained through any intended debt restructuring. This criterion applies only to public (domestic and external) debt. However, the analysis of such public debt sustainability will incorporate any relevant contingent liabilities, including those potentially arising from private external indebtedness. Assuming the successful completion of the debt operation, public debt is projected on a clearly downward path, reaching 72.2 percent of GDP by 2020. At the same time, gross financing needs remain on average significantly below DSA higher risk benchmarks during and after the program period, mitigating the risks associated with the high debt level. Sensitivity tests show that debt remains on a non-explosive path after a number of reasonable macroeconomic shocks. The shift in the composition of debt towards official debt with longer maturity and lower cost also lessens the risks. Thus, staff considers the debt to be sustainable in the medium term with high probability.

Criterion 3. *The member has prospects of gaining or regaining access to private capital markets within a timeframe and on a scale that would enable the member to meet its obligations falling due to the Fund.* 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 successful completion of the debt operation 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, combined with continued support from the international community, Ukraine has good prospects for regaining access to private capital markets on a scale that would enable it to meet its obligations falling due to the Fund.

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 program has remained broadly on track, with fiscal and monetary policies meeting targets and objectives. Key prior actions, including adoption of the 2017 budget, further cleaning up of the banking system, and measures to prevent the reemergence of losses in the energy sector have been implemented, notwithstanding the very difficult economic and political environment. While the fragile parliamentary majority is a key risk, as are pressures for populist policies and resistance to deeper reforms from vested interests, the prior actions demonstrate the authorities' ability to tackle major reforms affecting vested interests if given enough time. Also, the re-phasing of next steps in key reform areas leaves the program better aligned with observed implementation capacity. The conflict in the eastern part of Ukraine remains a major risk, albeit mitigated by the peace process. Overall, with the authorities' strong commitment to the program and with significant technical support from the Fund and other multilateral and bilateral creditors, the prospects for program success remain strong.

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

55. **Under the program scenario, Ukraine's capacity to repay the Fund remains adequate**. This assumes implementation of the envisaged policies and reforms, the revival of growth, the external and fiscal adjustment, and the buildup of reserves. As a result of the debt operation, gross financing needs are contained during the program period when the first large repayments come due to the Fund in 2018. In that year, debt service as a ratio of exports of goods and services would peak at 4½ percent. By the end of the arrangement in early 2019, outstanding credit to the Fund is projected at about 17.3 percent of GDP, or 59 percent of gross reserves.

56. Nonetheless, uncertainties surrounding the baseline scenario are large. The main risk continues to be the domestic political situation, followed by risks related to geopolitical developments. While the program can adapt and withstand moderate domestic and external economic shocks, Ukraine's ability to repay would be adversely affected if the program were interrupted due to weak performance or an intensification of the conflict that would weigh on market and investment sentiment.

D. Exchange System

57. Ukraine continues to maintain several exchange restrictions and Multiple Currency Practices (MCPs), but a roadmap has been put in place to gradually phase them out. The exchange restrictions arise from: (i) absolute limits on the availability of foreign exchange for certain non-trade current international transactions; and (ii) a partial ban on the transfer abroad of dividends received by nonresident investors from foreign investments in Ukraine. The MCPs arise from: (i) the use of multiple price foreign exchange auctions conducted by the NBU without a mechanism to prevent a spread deviation of more than 2 percent between the auction and market exchange rates; (ii) the use of the official exchange rate for exchange transactions with the government without a mechanism to prevent a spread deviation of more than 2 percent between the official exchange rate and market exchange rates; and (iii) the requirement to transfer any gains from the purchase of foreign exchange to the state budget if it is unused and resold. These were approved under Article VIII, Section 2(a) and 3 in September 2016 for a period of one year (see second review staff report (IMF Country Report No. 16/319)).

E. Program Monitoring

58. The attached Letter of Intent and MEFP describe the authorities' progress in implementing their economic program and set out their commitments. The authorities request a rephasing of pending structural benchmarks, taking into account reform priorities and the authorities' observed implementation capacity, and propose new structural benchmarks. They also propose performance criteria for end-June, end-September, and end-December 2017, as well as a new indicative targets on employment reduction in MEFP Table 1 to support the government's efforts to right size the public sector.

59. The authorities are requesting a rephasing of access under the program. In light of the delay in completing this review, the authorities are requesting a reduction in the number of reviews to 10 and a rephasing of remaining access to align purchases with reform progress and balance of payments needs (Table 8).

Structural Conditionality 1/

	Previous Timeline	New Timeline
Fiscal		
Adopt 2017 budget consistent with the program	…	PA
Merge tax and customs administrations	End-December 2016	End-March 2017
Parametric pension reform 2/	End-December 2016	End-April 2017
Reform of police for financial offences	…	End-April 2017
Establish a centralized database of recipients of social assistance	…	End-December 2017
Energy		
Reduce consumption norms 2/	End-September 2016	PA
Introduce automatic tariff adjustment mechanism 2/	End-October 2016	PA
Ensure subsidies remain within the budget ceiling	…	End-July 2017
Monetize utility subsidies at utility company level	…	End-August 2017
Financial sector		
Resolve banks that do not meet minimum capital requirements	…	PA
Contract firms for asset recovery and loan review	…	End-April 2017
Anticorruption		
Enforce high-level official asset declaration	End-October 2016	PA
Strengthen investigative powers of NABU	End-November 2016	End-May 2017
Anticorruption court legislation	…	Mid-June 2017
SOE reform and business environment		
Adopt land reform legislation 2/	End-September 2016	End-May 2017
Complete triage of SOEs	End-October 2016	End-August 2017
Amend privatization law to streamline processes	End-December 2016	End-August 2017
Strengthen payment discipline	End-September 2016	End-September 2017
Strengthen corporate insolvency regime	End-September 2016	End-September 2017

Source: IMF staff.

1/ Prior actions for the third review, and reset structural benchmarks (SBs) and proposed new SBs through 2017. Detailed descriptions of these measures can be found in Table 2 of the MEFP.

2/ SB has been modified (modified version presented).

STAFF APPRAISAL

60. After a difficult period, the Ukrainian economy is showing welcome signs of recovery. Decisive policy actions in the past two years have led to a dramatic reduction in external and internal imbalances. Inflation has been successfully brought under control, the central bank's international reserves have increased substantially, and growth has returned. The authorities deserve credit for tackling a number of weaknesses that had long plagued the Ukrainian economy, including by raising gas and heating tariffs to import parity, reigning in the large budgetary deficits, pursuing efforts to clean up the banking system, and maintaining a flexible exchange rate regime. However, the challenges ahead to lower vulnerabilities and build a vibrant, modern economy are still significant.

61. In this regard, despite some reform progress, the delay in other long-standing reforms in key program areas is regrettable, and the authorities need to strengthen their efforts to build the necessary political support. Against a fragile political environment, the authorities focused their recent efforts on a number of key measures, including the adoption of a 2017 budget consistent with program targets, adopting an automatic gas tariff adjustment mechanism to avoid the reemergence of quasi-fiscal deficits in the gas sector, the resolution and nationalization of the country's largest, but deeply insolvent bank, and the publication of high-level officials' asset declarations to enhance transparency. While these efforts are commendable, it is now critical that they are followed by long-overdue, but urgently-needed pension and land reform, and efforts to accelerate privatization and decisively tackle corruption, where, notwithstanding the creation of new anticorruption institutions, concrete results have yet to be achieved.

62. The recent decision to nationalize Ukraine's largest bank was an important demonstration of the authorities' ability to tackle vested interests to safeguard financial stability. This decision was appropriate to ensure the smooth operations of the bank given its systemic role in the country's financial system. It will now be crucial that the nationalization is followed by firm efforts, in line with existing legislation and international best practice, to ensure repayment of loans, to minimize the cost to the state and taxpayers. Moreover, ensuring that all banks operating in Ukraine meet capital and regulatory requirements remains essential to maintain public confidence in the banking system and reinforce the banks' ability to support growth.

63. Beyond its catalytic role in efforts to rehabilitate the banking system, the NBU has made impressive progress in containing inflation and rebuilding reserve buffers. These would not have been feasible without the NBU having a clear policy mandate and operational independence. It is important that its new strong institutional framework be preserved and protected. Going forward, continuing to meet inflation targets in the context of a floating exchange rate regime remains a key challenge. A further gradual easing of the monetary policy stance should continue as inflation expectations become better anchored and reserve accumulation remains on track. Similarly, the further relaxation of administrative measures should proceed as continued progress is made in entrenching financial stability and increasing reserves.

64. Notwithstanding the remarkable fiscal adjustment, medium-term fiscal sustainability will not be assured without ambitious structural fiscal reforms. The passage of a 2017 budget, as well as the adoption of an automatic gas and heating tariff adjustment mechanism are expected to support achievement of the 2017 fiscal targets. However, the urgency of structural fiscal reforms has been heightened, as pressures to increase wages and pensions are building, while public debt is still very high. In particular, Ukraine cannot afford to delay comprehensive pension reform for much longer. Repeated delays only strengthen vested interests and increase the eventual political cost. While the reaffirmation of the authorities' commitment to implement pension reform in 2017 is encouraging, it needs to be followed by systematic preparation and strong public communication to build the necessary support. Decisive and sustained efforts are also needed to improve tax administration and customs, where the momentum has recently stalled, and advance public administration reform, including critical health and education sector reforms, to improve the quality of public services.

65. More broadly, the challenges to build a vibrant, modern market economy and reduce vulnerabilities remain significant and Ukraine needs deeper reforms if it is to catch up with its regional peers. To achieve growth rates of 4 percent per year, the country needs to increase labor participation and attract significant investment, including foreign investment, which require substantial improvements in the business environment. In addition, SOE and land reform need to get underway, and stronger efforts are needed to root out corruption. Without this, it will not be possible to achieve the program's goals.

66. In view of the authorities' recent performance under the program and their commitments for the period ahead, staff recommends completion of the third review and the financing assurances review under the extended arrangement. Staff supports the completion of the financing assurances review on the basis that adequate safeguards remain in place for the further use of the Fund's resources in Ukraine's circumstances and that Ukraine's adjustment efforts have not been undermined by the developments in debtor-creditor relations. Staff furthermore supports the authorities' request for the rephasing of remaining access under the program, including to better align financing with policy implementation.

Table 1. Ukraine: Selected Economic and Social Indicators, 2013–21

	2013	2014	2015	2016		2017		2018	2019	2020	2021
		Actual		2nd Review	Est.	2nd Review	Proj.	Proj.	Proj.	Proj.	Proj.
Real economy (percent change, unless otherwise indicated)											
Nominal GDP (billions of Ukrainian hryvnias) 1/	1,465	1,587	1,979	2,281	2,280	2,596	2,626	2,953	3,289	3,624	3,996
Real GDP 1/	0.0	-6.6	-9.9	1.5	2.0	2.5	2.9	3.1	3.5	4.0	4.0
Contributions:											
Domestic demand	1.4	-13.3	-14.0	2.7	4.5	3.4	4.2	4.2	4.6	4.8	5.0
Private consumption	5.2	-6.5	-16.0	2.0	2.3	2.1	2.5	2.2	2.4	2.5	2.5
Public consumption	-0.2	0.2	0.2	-0.3	-0.3	0.0	-0.2	-0.1	-0.1	0.0	0.0
Investment	-3.6	-6.9	1.8	1.1	2.5	1.2	2.0	2.0	2.3	2.3	2.4
Net exports	-1.5	6.7	4.1	-1.2	-2.5	-0.9	-1.4	-1.0	-1.0	-0.9	-1.0
GDP deflator	4.3	15.9	38.4	13.5	13.0	11.0	12.0	9.0	7.5	6.0	6.0
Output gap (percent of potential GDP)	-0.3	-2.7	-6.7	-3.9	-3.4	-2.1	-1.7	-0.9	-0.5	-0.2	0.0
Unemployment rate (ILO definition; percent)	7.2	9.3	9.1	9.0	8.8	8.7	9.0	8.7	8.4	8.2	8.0
Consumer prices (period average)	-0.3	12.1	48.7	15.1	13.9	11.0	11.5	9.5	6.5	5.5	5.0
Consumer prices (end of period)	0.5	24.9	43.3	13.0	12.4	8.5	10.0	7.0	6.0	5.0	5.0
Nominal monthly wages (average)	8.0	6.1	21.1	17.5	23.3	14.6	28.0	12.0	10.5	10.0	9.5
Real monthly wages (average)	8.3	-5.3	-18.6	2.1	8.2	3.2	14.8	2.3	3.8	4.3	4.2
Savings (percent of GDP)	9.3	9.2	15.0	14.6	14.5	14.9	16.5	19.5	21.3	22.6	23.2
Private	12.1	12.4	13.8	15.4	13.6	15.8	16.7	19.1	20.6	21.5	21.8
Public	-2.8	-3.2	1.2	-0.8	0.9	-0.9	-0.2	0.5	0.8	1.2	1.4
Investment (percent of GDP)	18.5	13.4	15.3	16.1	18.3	17.0	19.5	22.2	24.1	25.2	26.1
Private	16.5	12.1	13.0	13.1	15.1	14.0	16.6	19.1	20.9	21.8	22.6
Public	2.0	1.3	2.4	2.9	3.2	3.1	2.9	3.1	3.2	3.4	3.5
Public finance (percent of GDP)											
General government balance 2/	-4.8	-4.5	-1.2	-3.7	-2.3	-3.1	-3.1	-2.6	-2.4	-2.2	-2.1
Overall balance (including Naftogaz operational deficit)	-6.7	-10.0	-2.2	-3.9	-2.4	-3.1	-3.1	-2.6	-2.4	-2.2	-2.1
Public and publicly-guaranteed debt	40.5	70.3	79.7	90.3	84.9	91.7	91.4	86.2	78.6	72.2	66.4
Money and credit (end of period, percent change)											
Base money	20.3	8.5	0.8	13.8	13.6	12.8	13.6	13.0	12.1	11.7	11.4
Broad money	17.6	5.3	3.9	17.6	10.9	18.5	11.3	19.3	15.4	15.0	12.2
At program exchange rate	13.3	-16.8	-7.6	12.7	7.5	20.7	9.3	18.5	15.9	14.5	12.1
Credit to nongovernment	11.8	12.4	-1.0	10.2	-1.1	12.3	7.4	8.5	11.4	10.2	10.5
At program exchange rate	9.5	-15.6	-19.4	2.2	-3.7	11.3	5.8	7.8	12.6	11.1	12.2
Velocity	1.6	1.7	2.0	2.0	1.8	1.9	2.1	2.0	1.9	1.9	1.8
Interbank overnight rate (annual average, percent)	3.8	12.2	21.5	...	16.9	...	...	...	...	...	...
Balance of payments (percent of GDP)											
Current account balance	-9.2	-4.2	-0.3	-1.5	-3.8	-2.1	-3.0	-2.6	-2.7	-2.6	-2.9
Foreign direct investment	2.3	0.2	3.3	2.4	3.8	2.4	1.7	2.5	3.2	3.6	3.4
Gross reserves (end of period, billions of U.S. dollars)	20.4	7.5	13.3	16.8	15.5	23.7	22.3	30.2	30.3	30.7	31.8
Months of next year's imports of goods and services	3.5	1.8	3.1	4.1	3.5	5.4	4.7	5.9	5.5	5.2	5.0
Percent of short-term debt (remaining maturity)	35.2	20.5	48.0	62.7	59.2	82.8	79.7	94.6	86.3	85.2	83.7
Percent of the IMF composite metric (float)	45.0	25.1	51.3	65.0	62.2	85.7	83.9	105.3	102.7	102.0	102.9
Goods exports (annual volume change in percent)	-14.7	-10.5	-13.4	-4.1	-3.4	3.7	4.8	7.5	6.3	6.2	5.6
Goods imports (annual volume change in percent)	-8.6	-25.0	-28.9	-1.8	6.3	4.0	2.0	4.8	8.5	8.5	6.9
Goods terms of trade (percent change)	-0.4	0.0	-14.6	-0.2	-0.7	0.5	2.9	-2.9	1.9	1.7	1.2
Exchange rate											
Hryvnia per U.S. dollar (end of period; actual)	8.0	15.8	24.0	...	26.9	...	...	...	...	...	...
Hryvnia per U.S. dollar (period average; actual)	8.2	12.0	21.9	...	25.5	...	...	...	...	...	...
Real effective rate (deflator-based, percent change)	-0.9	-20.9	-11.5	-3.9	-3.3	3.5	3.2	2.4	4.8	3.1	3.3
Real effective rate (deflator-based, 2010=100)	116.7	92.3	81.7	78.5	79.0	81.3	81.5	83.5	87.5	90.2	93.1
Memorandum items:											
Per capita GDP / Population (2016): US$2,087 / 42.6 million											
Literacy / Poverty rate (2015): 100 percent / 6.4 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 2a. Ukraine: General Government Finances, 2015–21 1/

(Billions of Ukrainian Hryvnias)

	2015	2016		2017		2018	2019	2020	2021
	Act.	2nd Review	Act.	2nd Review	Proj.	Proj.	Proj.	Proj.	Proj.
Revenue	832.9	869.6	914.1	986.2	1,064.6	1,198.9	1,333.1	1,466.7	1,602.0
Tax revenue	702.0	766.5	788.0	872.0	941.0	1,072.9	1,192.8	1,312.1	1,431.5
Tax on income, profits, and capital gains	139.0	184.2	199.0	211.7	229.2	256.5	286.6	315.1	344.3
Personal income tax	100.0	130.9	138.8	151.0	165.4	191.7	214.4	235.6	256.7
Corporate profit tax 2/	39.1	53.3	60.2	60.6	63.8	64.8	72.2	79.5	87.7
Social security contributions	190.4	127.8	131.8	143.0	165.7	192.1	214.9	236.1	257.2
Property tax	16.0	22.4	25.0	25.5	24.3	27.3	30.4	33.5	37.0
Tax on goods and services	261.8	330.1	344.4	371.9	423.8	489.4	542.3	596.6	650.1
VAT	178.5	232.1	235.5	263.6	293.1	341.2	378.0	416.2	453.9
Excise	70.8	91.9	101.8	101.7	124.8	141.6	157.0	172.3	187.3
Other	12.6	6.1	7.1	6.6	5.9	6.6	7.3	8.1	8.9
Tax on international trade	40.3	19.9	20.4	22.0	22.8	25.4	27.8	30.4	32.8
Other tax	54.4	82.0	67.4	98.0	75.3	82.2	90.8	100.3	110.0
Nontax revenue	130.9	103.0	126.1	114.2	123.6	126.0	140.3	154.6	170.5
Expenditure	855.9	954.4	967.1	1,100.8	1,146.5	1,354.6	1,537.6	1,719.7	1,874.2
Current	806.1	874.4	892.3	999.2	1,057.0	1,246.4	1,413.1	1,576.1	1,708.5
Compensation of employees	185.6	215.1	221.7	238.0	296.4	363.9	412.0	444.4	469.5
Goods and services	146.5	154.4	159.4	181.5	178.5	194.7	209.4	230.6	254.1
Interest	82.8	105.2	97.7	115.4	113.7	129.8	137.0	146.3	156.2
Subsidies to corporations and enterprises	25.6	19.5	23.4	21.3	32.3	35.4	37.7	39.8	41.8
Social benefits	364.0	378.5	388.3	441.2	433.7	519.9	614.1	711.9	783.6
Social programs (on budget)	75.6	102.3	110.5	113.9	126.8	142.6	158.8	175.1	193.0
Pensions	265.8	252.5	254.8	301.1	283.2	351.4	427.5	507.4	559.4
Unemployment, disability, and accident	22.7	23.7	23.0	26.3	23.7	25.8	27.8	29.4	31.2
Other current expenditures	1.6	1.8	1.8	1.8	2.5	2.7	2.9	3.0	3.2
Capital	46.7	65.5	73.0	81.5	77.4	89.7	104.0	121.0	140.7
Net lending	3.1	11.0	1.8	12.3	8.6	9.6	10.7	11.8	13.0
Contingency reserve	0.0	3.5	0.0	7.8	3.5	8.9	9.9	10.9	12.0
Unidentified measures	0.0	0.0	0.0	30.5	0.0	78.8	125.6	173.3	188.4
General government overall balance	-23.1	-84.9	-53.0	-81.2	-81.8	-76.8	-78.9	-79.7	-83.9
Naftogaz operational balance	-20.5	-5.1	-1.0	0.0	0.0	0.0	0.0	0.0	0.0
General government and Naftogaz balance	-43.6	-90.0	-54.0	-81.3	-81.8	-76.8	-78.9	-79.7	-83.9
General government financing	23.1	84.9	53.0	81.2	81.8	76.8	78.9	79.7	83.9
External	101.3	74.2	35.4	50.3	76.2	46.6	-64.6	-70.3	5.5
Disbursements	133.5	83.9	47.6	76.3	104.6	99.9	94.2	92.1	110.1
Amortizations	-32.2	-9.7	-12.3	-26.0	-28.3	-53.4	-158.8	-162.4	-104.7
Domestic (net)	-78.3	10.7	17.6	31.0	5.6	30.2	143.6	150.0	78.4
Bond financing 3/	-55.0	-37.4	21.7	11.5	-11.5	14.9	109.6	114.2	64.7
Direct bank borrowing	-1.7	0.0	-2.0	0.0	0.0	0.0	0.0	0.0	0.0
Deposit finance	-31.2	31.0	-2.7	0.0	0.0	0.0	17.0	17.0	0.0
Privatization	9.6	17.1	0.7	19.5	17.1	15.3	17.0	18.8	13.8
Naftogaz financing	20.5	5.1	1.0	0.0	0.0	0.0	0.0	0.0	0.0
Government financing 4/	29.9	0.0	0.1	37.3	37.8	0.0	0.0	0.0	0.0
Change in external arrears	0.0	0.0	0.0	-37.3	-37.8	0.0	0.0	0.0	0.0
Other 5/	-9.4	5.1	0.9	0.0	0.0	0.0	0.0	0.0	0.0
Bank and DGF recapitalization	45.3	166.0	129.0	42.0	98.0	0.0	0.0	0.0	0.0
Total financing	88.9	256.0	183.0	123.3	179.8	76.8	78.9	79.7	83.9
Memorandum items:									
Primary balance	59.7	20.3	44.7	34.2	31.8	53.0	58.1	66.6	72.3
Cyclically-adjusted primary balance 6/	119.1	55.8	77.2	52.2	49.7	63.4	64.8	69.5	72.4
Structural primary balance 6/ 7/	71.2	37.5	69.8	52.2	26.5	63.4	64.8	69.5	72.4
Public and publicly-guaranteed debt	1,578	2,059	1,936	2,380	2,400	2,545	2,586	2,617	2,652

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

1/ National methodology, cash basis.

2/ Assumes excess CIT payments are cleared over 2017-18.

3/ Domestic bonds have been adjusted to reflect discrepancy between the above-the-line and the below-the-line deficits.

4/ Government spending on Naftogaz financing and recapitalization, including through T-bills issuance.

5/ Includes external and domestic net disbursements, domestic arrears accumulation, and deposit drawdowns.

6/ For the calculation of these balances, it is asumed that the unidentified measures are on the expenditure side.

7/ The balance in 2015 treats import duty surcharges, part of the NBU profit transfer, nonpayment of pensions for working pensioners and advancement of 2016 pensions as one-off operations. This advanced pension payment and the advancement of 2017 pensions to 2016, as well as the nonpayment of pensions for working pensioners are also part of the 2016/17 balances. Part of the NBU profit transfer in 2017 is considered a one-off operation.

Table 2b. Ukraine: General Government Finances, 2015–21 1/

(Percent of GDP)

	2015	2016		2017		2018	2019	2020	2021
	Act.	2nd Review	Act.	2nd Review	Proj.	Proj.	Proj.	Proj.	Proj.
Revenue	42.1	38.1	40.1	38.0	40.5	40.6	40.5	40.5	40.1
Tax revenue	35.5	33.6	34.6	33.6	35.8	36.3	36.3	36.2	35.8
Tax on income, profits, and capital gains	7.0	8.1	8.7	8.2	8.7	8.7	8.7	8.7	8.6
Personal income tax	5.1	5.7	6.1	5.8	6.3	6.5	6.5	6.5	6.4
Corporate profit tax 2/	2.0	2.3	2.6	2.3	2.4	2.2	2.2	2.2	2.2
Social security contributions	9.6	5.6	5.8	5.5	6.3	6.5	6.5	6.5	6.4
Property tax	0.8	1.0	1.1	1.0	0.9	0.9	0.9	0.9	0.9
Tax on goods and services	13.2	14.5	15.1	14.3	16.1	16.6	16.5	16.5	16.3
VAT	9.0	10.2	10.3	10.2	11.2	11.6	11.5	11.5	11.4
Excise	3.6	4.0	4.5	3.9	4.8	4.8	4.8	4.8	4.7
Other	0.6	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2
Tax on international trade	2.0	0.9	0.9	0.8	0.9	0.9	0.8	0.8	0.8
Other tax	2.7	3.6	3.0	3.8	2.9	2.8	2.8	2.8	2.8
Nontax revenue	6.6	4.5	5.5	4.4	4.7	4.3	4.3	4.3	4.3
Expenditure	43.2	41.8	42.4	42.4	43.7	45.9	46.8	47.5	46.9
Current	40.7	38.3	39.1	38.5	40.3	42.2	43.0	43.5	42.8
Compensation of employees	9.4	9.4	9.7	9.2	11.3	12.3	12.5	12.3	11.8
Goods and services	7.4	6.8	7.0	7.0	6.8	6.6	6.4	6.4	6.4
Interest	4.2	4.6	4.3	4.4	4.3	4.4	4.2	4.0	3.9
Subsidies to corporations and enterprises	1.3	0.9	1.0	0.8	1.2	1.2	1.1	1.1	1.0
Social benefits	18.4	16.6	17.0	17.0	16.5	17.6	18.7	19.6	19.6
Social programs (on budget)	3.8	4.5	4.8	4.4	4.8	4.8	4.8	4.8	4.8
Pensions	13.4	11.1	11.2	11.6	10.8	11.9	13.0	14.0	14.0
Unemployment, disability, and accident	1.1	1.0	1.0	1.0	0.9	0.9	0.8	0.8	0.8
Other current expenditures	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Capital	2.4	2.9	3.2	3.1	2.9	3.0	3.2	3.3	3.5
Net lending	0.2	0.5	0.1	0.5	0.3	0.3	0.3	0.3	0.3
Contingency reserve	0.0	0.2	0.0	0.3	0.1	0.3	0.3	0.3	0.3
Unidentified measures	0.0	0.0	0.0	1.2	0.0	2.7	3.8	4.8	4.7
General government overall balance	-1.2	-3.7	-2.3	-3.1	-3.1	-2.6	-2.4	-2.2	-2.1
Naftogaz operational balance	-1.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
General government and Naftogaz balance	-2.2	-3.9	-2.4	-3.1	-3.1	-2.6	-2.4	-2.2	-2.1
General government financing	1.2	3.7	2.3	3.1	3.1	2.6	2.4	2.2	2.1
External	5.1	3.3	1.6	1.9	2.9	1.6	-2.0	-1.9	0.1
Disbursements	6.7	3.7	2.1	2.9	4.0	3.4	2.9	2.5	2.8
Amortizations	-1.6	-0.4	-0.5	-1.0	-1.1	-1.8	-4.8	-4.5	-2.6
Domestic (net)	-4.0	0.5	0.8	1.2	0.2	1.0	4.4	4.1	2.0
Bond financing 3/	-2.8	-1.6	1.0	0.4	-0.4	0.5	3.3	3.2	1.6
Direct bank borrowing	-0.1	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Deposit finance	-1.6	1.4	-0.1	0.0	0.0	0.0	0.5	0.5	0.0
Privatization	0.5	0.7	0.0	0.8	0.7	0.5	0.5	0.5	0.3
Naftogaz financing	1.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Government financing 4/	1.5	0.0	0.0	1.9	1.9	0.0	0.0	0.0	0.0
Accumulation of external arrears	0.0	0.0	0.0	-1.9	-1.9	0.0	0.0	0.0	0.0
Other 5/	-0.5	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Bank and DGF recapitalization	2.3	7.3	5.7	1.6	3.7	0.0	0.0	0.0	0.0
Total financing	4.5	11.2	8.0	4.7	6.8	2.6	2.4	2.2	2.1
Memorandum items:									
Primary balance	3.0	0.9	2.0	1.3	1.2	1.8	1.8	1.8	1.8
Cyclically-adjusted primary balance 6/	6.0	2.4	3.4	2.0	1.9	2.1	2.0	1.9	1.8
Structural primary balance 6/ 7/	3.6	1.6	3.1	2.0	1.0	2.1	2.0	1.9	1.8
Public and publicly-guaranteed debt	79.7	90.3	84.9	91.7	91.4	86.2	78.6	72.2	66.4

Sources: Ministry of Finance; National Bank of Ukraine; and IMF staff estimates and projections.
1/ National methodology, cash basis.
2/ Assumes excess CIT payments are cleared over 2017-18.
3/ Domestic bonds have been adjusted to reflect discrepancy between the above-the-line and the below-the-line deficits.
4/ Government spending on Naftogaz financing and recapitalization, including through T-bills issuance.
5/ Includes external and domestic net disbursements, domestic arrears accumulation, and deposit drawdowns.
6/ For the calculation of these balances, it is asumed that the unidentified measures are on the expenditure side.
7/ The balance in 2015 treats import duty surcharges, part of the NBU profit transfer, nonpayment of pensions for working pensioners and advancement of 2016 pensions as one-off operations. This advanced pension payment and the advancement of 2017 pensions to 2016, as well as the nonpayment of pensions for working pensioners are also part of the 2016/17 balances. Part of the NBU profit transfer in 2017 is considered a one-off operation.

Table 3. Ukraine: Balance of Payments, 2015–21 1/

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

	2015	2016		2017		2018	2019	2020	2021
	Act.	2nd Review	Act.	2nd Review	Proj.	Proj.	Proj.	Proj.	Proj.
A. Current account balance	-0.3	-1.3	-3.4	-2.0	-2.9	-2.7	-3.1	-3.2	-3.9
Goods (net)	-3.3	-3.7	-6.8	-3.9	-5.0	-5.5	-6.1	-6.8	-7.3
Exports	35.4	32.6	33.6	34.6	36.8	39.2	42.4	45.8	49.0
Imports	-38.7	-36.4	-40.4	-38.5	-41.9	-44.7	-48.5	-52.7	-56.4
Of which : gas	-4.4	-1.8	-2.3	-2.3	-2.4	-2.7	-2.9	-3.2	-3.2
Services (net)	1.6	2.1	1.2	2.2	1.2	1.6	1.8	1.8	1.7
Receipts	12.4	12.0	12.3	12.8	13.0	13.9	14.7	15.6	16.4
Payments	-10.8	-9.9	-11.1	-10.5	-11.8	-12.3	-13.0	-13.8	-14.7
Primary income (net)	-1.2	-2.1	-0.7	-2.8	-1.6	-1.5	-1.4	-0.9	-1.0
Secondary income (net)	2.6	2.4	2.9	2.5	2.6	2.7	2.7	2.7	2.7
B. Capital account balance 2/	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
C. Financial account balance	4.9	0.8	-3.7	-1.9	-1.6	-7.3	-3.5	-3.5	-5.6
Direct investment (net) 3/	-3.0	-2.1	-3.4	-2.3	-1.7	-2.5	-3.7	-4.4	-4.6
Portfolio investment (net)	2.4	-0.9	-0.3	-1.3	-1.0	-2.8	1.5	0.9	-0.5
Portfolio investment: assets	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Portfolio investment: liabilities	-2.4	0.9	0.2	1.3	1.0	2.8	-1.5	-0.9	0.5
Equity	0.2	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Debt securities	-2.6	0.9	0.2	1.3	1.0	2.8	-1.5	-0.9	0.5
General government	-1.8	0.9	0.3	1.0	1.0	2.0	-1.8	-1.7	-0.5
Banks	-0.6	0.0	-0.1	0.3	0.0	0.3	0.1	0.5	0.4
Other sectors	-0.1	0.0	0.0	0.0	0.0	0.5	0.2	0.4	0.7
Financial derivatives (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment (net)	5.5	3.7	-0.1	1.6	1.1	-2.0	-1.3	0.0	-0.5
Other investment: assets	-1.1	-0.6	-4.6	0.3	-1.1	-1.0	-0.6	0.0	0.0
Central Bank 4/	-0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Banks	0.4	0.9	-0.7	0.4	0.5	0.0	0.0	0.0	0.0
Other sectors	-1.5	-1.6	-4.0	0.0	-1.5	-1.0	-0.6	0.0	0.0
Of which: FX cash outside the banking system 5/	-1.8	-1.7	-4.7	0.0	-1.5	-1.0	-0.6	0.0	0.0
Of which: Trade credit	0.5	0.2	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Other investment: liabilities	-6.6	-4.4	-4.6	-1.3	-2.2	1.0	0.7	0.0	0.5
Central Bank 4/	1.5	-1.2	-1.3	0.0	0.0	0.0	0.0	0.0	0.0
General government 6/	-0.3	-0.5	-0.4	-0.5	-0.5	-0.5	-0.7	-1.4	-0.9
Banks 3/	-4.3	-1.8	-2.6	0.4	0.4	0.7	0.6	0.5	0.5
Other sectors	-3.5	-0.9	-0.3	-1.3	-2.0	0.9	0.8	0.8	0.9
Loans	-1.7	-1.5	-1.0	0.2	-0.7	0.4	0.3	0.3	0.3
Trade credit 7/	-1.7	0.6	0.7	-1.5	-1.4	0.5	0.6	0.6	0.6
D. Errors and omissions	-0.6	-0.3	-0.5	0.0	0.0	0.0	0.0	0.0	0.0
E. Overall balance (A+B-C+D)	-5.3	-2.3	-0.2	-0.1	-1.3	4.6	0.4	0.3	1.8
F. Financing	5.4	2.3	0.5	0.1	1.3	-4.6	-0.4	-0.3	-1.8
Gross official reserves (increase: -)	-6.0	-3.3	-2.3	-6.9	-6.8	-7.9	-0.1	-0.4	-1.0
Net use of IMF resources	5.2	2.3	1.0	4.5	4.6	1.8	-1.5	-1.1	-1.5
Of which: Prospective Fund purchases	6.5	2.3	1.0	5.4	5.5	3.8	0.0	0.0	0.0
Official financing 8/	3.2	3.3	1.8	2.5	3.5	1.5	1.2	1.1	0.7
World Bank/IFC	1.2	0.7	0.2	0.5	0.8	0.5	0.6	0.6	0.3
EU	0.9	0.9	0.1	0.7	1.3	0.0	0.0	0.0	0.0
EBRD/EIB/Others	1.1	1.7	1.4	1.3	1.4	0.9	0.7	0.6	0.4
Exceptional financing	3.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Total external debt (percent of GDP)	130.6	141.3	129.4	136.3	128.5	126.3	113.5	103.8	95.3
Current account balance (percent of GDP)	-0.3	-1.5	-3.8	-2.1	-3.0	-2.6	-2.7	-2.6	-2.9
Goods and services trade balance (percent of GDP)	-1.9	-1.9	-6.3	-1.8	-4.0	-3.8	-3.8	-4.0	-4.2
Gross international reserves	13.3	16.8	15.5	23.7	22.3	30.2	30.3	30.7	31.8
Months of next year's imports of goods and services	3.1	4.1	3.5	5.4	4.7	5.9	5.5	5.2	5.0
Percent of short-term debt (remaining maturity)	48.0	62.7	59.2	82.8	79.7	94.6	86.3	85.2	83.7
Percent of the IMF composite metric	51.3	65.0	62.2	85.7	83.9	105.3	102.7	102.0	102.9
Goods export value (percent change)	-29.9	-7.8	-5.2	6.0	9.7	6.4	8.1	8.1	7.0
Goods import value (percent change)	-33.9	-6.0	4.2	5.8	3.7	6.8	8.4	8.6	7.1
Goods export volume (percent change)	-13.4	-4.1	-3.4	3.7	4.8	7.5	6.3	6.2	5.6
Goods import volume (percent change)	-28.9	-1.8	6.3	4.0	2.0	4.8	8.5	8.5	6.9
Goods terms of trade (percent change)	-14.6	-0.2	-0.7	0.5	2.9	-2.9	1.9	1.7	1.2
Gross domestic product (current prices)	90.5	87.2	89.2	…	…	…	…	…	…

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

1/ Based on BPM6.

2/ Official capital transfers are reported below the line.

3/ Includes banks' debt for equity operations in 2015 and 2016.

4/ Reflects currency swap transactions.

5/ Mainly reflects residents' conversion of UAH cash to FX held outside the banking system and its usage to finance informal trade.

6/ Only reflects principal amortization. Disbursements from the World Bank, IFC, EU, EIB, EBRD, and official bilaterals are recorded below the line.

7/ Includes clearance of Naftogaz potential arrears to Gazprom in 2017.

8/ Includes project financing to the public and private sector. The Eurobond issuance of US$2 billion with U.S. guarantees is included above the line in portfolio investment: liabilities, debt securities, and general government.

Table 4. Ukraine: Gross External Financing Requirements, 2015–21

(Billions of U.S. dollars)

	2015	2016		2017		2018	2019	2020	2021
	Act.	2nd Review	Act.	2nd Review	Proj.	Proj.	Proj.	Proj.	Proj.
Total financing requirements	42.1	46.2	25.3	41.7	34.1	34.5	39.3	43.5	44.6
Current account deficit	0.3	1.3	3.4	2.0	2.9	2.7	3.1	3.2	3.9
Portfolio investment	4.3	0.1	1.0	0.0	0.0	0.2	5.0	5.1	4.2
Private	0.8	0.0	0.1	0.0	0.0	0.2	1.2	1.4	0.7
General government	3.5	0.1	0.8	0.0	0.0	0.0	3.8	3.7	3.5
Medium and long-term debt	12.3	12.7	6.7	6.2	6.2	7.6	6.3	9.1	9.8
Private	12.0	12.2	6.3	5.7	5.7	7.1	5.6	7.7	9.0
Banks	4.1	2.7	3.0	0.7	0.5	1.0	1.4	1.6	2.0
Corporates	7.8	9.5	3.3	5.0	5.2	6.1	4.3	6.1	7.0
General government	0.3	0.5	0.4	0.5	0.5	0.5	0.7	1.4	0.9
Short-term debt (including deposits)	15.5	13.2	6.0	14.0	13.5	13.7	13.8	13.8	13.8
Other net capital outflows 1/	-1.1	0.5	-3.6	0.3	-1.1	-1.0	-0.6	0.0	0.0
Trade credit	10.9	18.5	11.9	19.2	12.6	11.2	11.8	12.3	12.9
Total financing sources	37.8	44.6	25.5	41.6	33.7	39.1	39.8	43.8	46.4
Capital transfers 2/	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Direct investment, net	3.0	2.1	3.4	2.3	1.7	2.5	3.7	4.4	4.6
Portfolio investment	1.9	1.0	1.2	1.3	1.0	3.0	3.5	4.3	4.8
Private	0.3	0.0	0.1	0.3	0.0	1.0	1.5	2.3	1.8
General government	1.7	1.0	1.1	1.0	1.0	2.0	2.0	2.0	3.0
Of which : Eurobond issuance	1.0	1.0	1.0	1.0	1.0	2.0	2.0	2.0	3.0
Medium and long-term debt	7.3	8.9	2.5	5.9	6.0	7.7	6.3	8.2	9.5
Private	7.3	8.9	2.5	5.9	6.0	7.7	6.3	8.2	9.5
Banks	1.2	0.9	0.2	0.9	0.8	1.4	1.7	1.9	2.3
Corporates	6.1	8.0	2.3	5.0	5.2	6.4	4.6	6.3	7.2
General government 2/	…	…	…	…	…	…	…	…	…
Short-term debt (including deposits)	14.2	13.4	5.9	14.5	13.8	14.1	14.0	14.0	14.0
Trade credit	11.0	19.2	12.6	17.7	11.2	11.8	12.3	12.9	13.5
Increase in gross reserves	6.0	3.3	2.3	6.9	6.8	7.9	0.1	0.4	1.0
Errors and omissions	-0.6	-0.3	-0.5	0.0	0.0	0.0	0.0	0.0	0.0
Total financing needs	9.6	5.1	2.6	7.0	7.2	3.3	-0.3	0.1	-0.7
Official financing	8.3	5.6	2.8	7.0	7.2	3.3	-0.3	0.1	-0.7
IMF	5.2	2.3	1.0	4.5	4.6	1.8	-1.5	-1.1	-1.5
Prospective purchases	6.5	2.3	1.0	5.4	5.5	3.8	0.0	0.0	0.0
Repurchases	1.4	0.0	0.0	0.9	0.8	2.0	1.5	1.1	1.5
Official creditors 3/	3.2	3.3	1.8	2.5	2.6	1.5	1.2	1.1	0.7
World Bank	1.2	0.7	0.2	0.5	0.2	0.5	0.6	0.6	0.3
EU	0.9	0.9	0.1	0.7	1.3	0.0	0.0	0.0	0.0
EBRD/EIB/Others	1.1	1.7	1.4	1.3	1.1	0.9	0.7	0.6	0.4
Exceptional financing	3.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Gross international reserves	13.3	16.8	15.5	23.7	22.3	30.2	30.3	30.7	31.8
Months of next year's imports of goods and services	3.1	4.1	3.5	5.4	4.7	5.9	5.5	5.2	5.0
Percent of short-term debt (remaining maturity)	48.0	62.7	59.2	82.8	79.7	94.6	86.3	85.2	83.7
Percent of the IMF composite metric 4/	51.3	65.0	62.2	85.7	83.9	105.3	102.7	102.0	102.9
Loan rollover rate (percent) 5/									
Banks	87.8	102.1	101.1	106.5	105.4	109.4	107.7	106.7	106.4
Corporates	82.8	98.5	280.3	101.8	101.9	102.7	102.4	101.9	101.9
Total	79.7	92.6	132.7	103.5	103.1	105.0	104.5	103.6	103.5

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

1/ Reflects changes in banks', corporates', and households' gross foreign assets as well as currency swap transactions.

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

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

4/ The IMF composite measure is calculated as a weighted sum of short-term debt, other portfolio and investment liabilities, broad money, and exports. Official reserves are recommended to be in the range of 100–150 percent of the appropriate measure.

5/ For banks, rollover rates (including short-term, long-term loans and non-resident deposits) are adjusted to exclude the impact of debt relief and debt for equity operations reflected on capital transfers and FDI, respectively. For corporates, rollover rates include as financing not only new inflows but also the deferment of external liabilities through the ongoing restructuring of private sector debt.

Table 5. Ukraine: Monetary Accounts, 2015–21

(Billions of Ukrainian hryvnias, unless otherwise noted)

	2015	2016		2017					2018	2019	2020	2021
	Dec.	Dec.		Mar.	Jun.	Sep.	Dec.					
	Act.	2nd Review	Act.	Proj.	Proj.	Proj.	2nd Review	Proj.	Proj.	Proj.	Proj.	Proj.
Monetary survey												
Net foreign assets	-35	7	64	73	80	62	51	110	267	300	329	389
(In billions of U.S. dollars)	-1.4	0.3	2.4	2.7	2.9	2.2	1.8	3.8	9.2	10.2	11.2	13.1
Net domestic assets	1,029	1,162	1,038	1,014	1,050	1,113	1,335	1,116	1,197	1,390	1,613	1,791
Domestic credit	1,503	1,620	1,673	973	1,023	1,082	1,825	1,808	1,914	2,174	2,438	2,654
Net claims on government	466	483	624	0	0	0	550	685	700	826	958	1,022
Credit to the economy	1,013	1,116	1,003	973	1,023	1,082	1,254	1,077	1,168	1,302	1,434	1,585
Domestic currency	465	477	508	484	537	573	528	568	607	703	798	925
Foreign currency	548	639	494	489	486	510	727	508	561	598	636	660
(In billions of U.S. dollars)	22.9	23.3	18.4	18.0	17.9	18.3	26.1	17.5	19.2	20.4	21.6	22.3
Other items, net	-475	-458	-635	41	27	31	-490	-691	-717	-784	-825	-862
Broad money	994	1,169	1,103	1,087	1,130	1,175	1,386	1,227	1,463	1,690	1,943	2,180
Currency in circulation	283	306	314	305	324	326	340	352	390	433	479	533
Total deposits	711	863	788	782	805	849	1,045	875	1,073	1,256	1,463	1,646
Domestic currency deposits	392	460	426	407	427	451	626	469	574	697	810	914
Foreign currency deposits	320	403	362	375	378	398	419	406	499	559	653	732
(In billions of U.S. dollars)	13.3	14.6	13.5	13.8	13.9	14.3	15.1	14.0	17.1	19.1	22.1	24.8
Accounts of the NBU												
Net foreign assets	34	59	116	131	145	136	125	190	366	417	462	538
(In billions of U.S. dollars)	1.4	2.1	4.3	4.8	5.3	4.9	4.5	6.5	12.6	14.2	15.7	18.2
Net international reserves	32	102	115	129	143	134	169	188	365	415	461	536
(In billions of U.S. dollars)	1.4	3.7	4.3	4.8	5.3	4.8	6.1	6.5	12.5	14.1	15.6	18.1
Reserve assets	319	462	423	462	536	571	660	648	881	890	907	940
(In billions of U.S. dollars)	13.3	16.8	15.7	17.0	19.7	20.6	23.7	22.3	30.3	30.3	30.8	31.8
Other net foreign assets	2	-43	2	2	2	2	-44	2	2	2	2	2
Net domestic assets	302	324	265	249	261	279	306	243	123	132	151	145
Net domestic credit	375	372	358	342	321	347	370	318	184	219	246	254
Net claims on government	363	365	355	361	307	317	342	323	264	203	172	159
Claims on government 1/	414	377	403	407	394	383	354	371	312	234	186	173
Liabilities to government 2/	51	12	48	46	87	66	12	48	48	31	14	14
o/w central gov. deposits												
Net claims on the economy	0	0	0	0	0	0	0	0	0	0	0	0
Net claims on banks	13	6	3	-19	14	30	28	-4	-80	16	74	95
Other items, net	-74	-48	-93	-93	-59	-68	-64	-75	-61	-87	-95	-109
Base money	336	382	382	380	406	414	431	433	490	549	613	683
Currency in circulation	283	306	314	305	324	326	340	352	390	433	479	533
Banks' reserves	53	77	67	75	82	88	91	82	99	116	134	150
Cash in vault 3/	26	25	27	26	27	29	30	30	36	43	50	56
Correspondent accounts	28	52	41	49	54	59	61	52	63	73	84	94
Deposit money banks												
Net foreign assets	-69	-52	-52	-58	-65	-73	-75	-79	-100	-117	-133	-149
(In billions of U.S. dollars)	-2.9	-1.9	-1.9	-2.1	-2.4	-2.6	-2.7	-2.7	-3.4	-4.0	-4.5	-5.0
Foreign assets	181	183	178	175	172	172	172	177	171	165	159	152
(In billions of U.S. dollars)	7.6	6.7	6.6	6.4	6.3	6.2	6.2	6.1	5.9	5.6	5.4	5.1
Foreign liabilities	250	240	230	232	236	243	252	256	270	282	292	301
Net domestic assets	780	914	840	840	870	922	1,119	954	1,172	1,373	1,596	1,795
Domestic credit	1,217	1,360	1,417	1,431	1,476	1,543	1,581	1,606	1,864	2,106	2,361	2,584
Net claims on government 4/	104	117	269	283	304	321	208	362	435	623	785	863
Credit to the economy	1,013	1,116	1,002	973	1,023	1,082	1,254	1,076	1,168	1,301	1,434	1,585
Other claims on the economy	23	20	46	46	46	46	20	46	46	46	46	46
Net claims on NBU	77	105	99	129	102	93	99	121	215	135	95	89
Of which : refinancing loans	106	63	75	73	70	68	56	68	61	55	51	51
Other items, net 4/	-438	-445	-577	-591	-607	-620	-462	-652	-692	-733	-765	-789
Banks' liabilities	711	862	788	782	805	849	1,045	875	1,073	1,256	1,463	1,646
Demand deposits	291	...	...				...	...	...	...	...	...
Savings and time deposits	420	...	...				...	...	...	...	...	...
Memorandum items:				(End of period, percent change unless otherwise noted)								
Base money	0.8	13.8	13.6	-0.4	6.4	8.6	12.8	13.6	13.0	12.1	11.7	11.4
Currency in circulation	-0.1	8.2	11.2	-3.1	3.2	3.8	11.2	11.8	10.9	11.0	10.6	11.2
Broad money	3.9	17.6	10.9	-1.4	2.4	6.6	18.5	11.3	19.3	15.4	15.0	12.2
At program exchange rate	-7.6	12.7	7.5	-2.1	2.1	5.6	20.7	9.3	18.5	15.9	14.5	12.1
Credit to the economy	-1.0	10.2	-1.1	-2.9	2.1	8.0	12.3	7.4	8.5	11.4	10.2	10.5
At program exchange rate	-19.4	2.2	-3.7	-3.3	2.9	8.4	11.3	5.8	7.8	12.6	11.1	12.2
Real credit to the economy 5/	-30.9	-2.5	-12.0	-18.5	-8.5	-2.7	3.6	-2.4	1.4	5.1	4.9	5.2
Credit-to-GDP ratio, in percent	51.2	48.9	44.0	41.7	42.3	43.0	48.3	41.0	39.5	39.6	39.6	39.7
Velocity of broad money, ratio	1.99	1.95	1.82	2.15	2.14	2.14	1.87	2.14	2.02	1.95	1.87	1.83
Money multiplier, ratio	2.96	3.06	2.89	2.86	2.78	2.84	3.21	2.83	2.99	3.08	3.17	3.19

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

1/ Includes purchases of Naftogaz and PrivatBank recapitalization bonds and DGF financing.

2/ Liabilities include advances for NBU profit transfer and deposits of DGF.

3/ During 2015 only, cash in vault was counted towards required reserves.

4/ Includes claims for recapitalization of banks.

5/ Deflated by CPI (eop), at current exchange rates, year-on-year percent change.

Table 6. Ukraine: Financial Soundness Indicators for the Banking Sector, 2015–16

(Percent, unless otherwise indicated)

	2015				2016			
	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
Ownership								
Number of banks, *of which 1/*	148	139	131	120	116	110	103	100
Private	141	133	125	114	110	104	98	94
Domestic	95	93	84	73	67	63	57	53
Foreign	46	40	41	41	43	41	41	41
Of which: 100% foreign-owned	19	18	18	17	17	17	18	19
State-owned	3	3	3	3	3	3	2	2
State-controlled (inc. in sanation)	4	3	3	3	3	3	3	4
Foreign-owned banks' share in statutory capital	30.5	31.1	36.2	42.5	45.2	51.2	53.0	51.0
Concentration								
Share of assets of largest 10 banks	63.8	65.9	68.2	70.6	71.4	72.4	73.1	72.2
Share of assets of largest 25 banks	83.8	86.1	87.3	88.7	89.7	90.7	91.6	91.4
Number of bank with assets less than $150 million	99	95	92	85	84	77	72	68
Capital Adequacy								
Regulatory capital to risk-weighted assets 2/	8.4	9.0	7.1	12.3	12.0	13.0	13.8	13.9
Capital to total assets	6.0	7.6	9.7	8.0	10.4	11.1	11.8	9.8
Asset Quality								
Credit growth (year-over-year percent change) 3/	-17.4	-19.0	-21.3	-19.4	-16.5	-13.4	-6.6	-3.7
Credit at program exchange rate growth (year-over-year percent change) 3/	-17.4	-19.0	-21.3	-19.4	-16.5	-13.4	-6.6	-3.7
Credit to GDP ratio 3/	72.6	61.3	54.4	51.2	51.1	46.4	45.4	44.2
Change of loan to GDP ratio (year-over-year, percentage points) 3/	4.8	-4.5	-10.2	-13.3	-21.6	-14.9	-14.9	-12.4
NPLs to total loans (NBU definition) 4/	24.7	24.3	25.6	28.0	29.7	30.4	31.0	30.5
NPLs to total loans (broader definition) 5/	39.7	45.2	45.3	46.4	47.6	48.2	46.6	49.4
NPLs net of provisions to capital (NBU definition) 4/	129.5	94.9	84.2	129.0	102.6	93.6	91.6	89.4
NPLs net of provisions to capital (broader definition) 5/	367.2	348.7	269.8	333.1	259.4	233.6	206.4	218.1
Specific narrow provisions (percent of NPLs, NBU definition) 4/	70.2	71.0	68.5	63.8	64.5	64.8	65.0	65.1
Specific broad provisions (percent of NPLs, broader definition) 5/	47.9	43.3	44.1	44.8	45.4	46.2	48.9	45.6
Total specific provisions (percent of total loans, broader definition)	26.1	20.4	20.8	23.5	24.3	24.9	25.2	…
Foreign Exchange Rate Risk								
Loans in foreign currency to total loans 3/	55.3	51.9	52.1	54.1	55.7	54.2	52.5	49.3
Deposits in foreign currency to total deposits	53.2	47.9	46.5	44.9	48.4	46.1	47.4	46.0
Foreign currency loans to foreign currency deposits 3/	168.0	165.9	168.8	171.6	163.9	155.1	147.8	136.4
Net open FX position to capital 6/	113.4	98.1	95.2	136.0	134.3	122.5	118.0	118.9
Net open FX position to regulatory capital (staff estimate) 7/	-97.2	-80.6	-86.0	-70.3	-51.2	-40.2	-20.4	-20.4
Liquidity Risk								
Liquid assets to total assets	26.8	27.9	29.9	33.0	35.6	38.4	39.4	…
Customer deposits to total loans to the economy	61.8	65.3	66.3	70.2	70.2	75.7	75.0	…
Earnings and Profitability								
Return on assets (after tax; end-of-period) 8/	-22.3	-11.7	-6.7	-5.4	-2.4	-2.1	-1.2	-1.2
Return on equity (after tax; end-of-period) 8/	-285.9	-157.9	-90.4	-70.0	-26.3	-20.6	-11.6	…
Net interest margin to total assets	3.6	4.0	3.9	3.0	3.3	3.5	3.5	…
Interest rate spreads (percentage points; end-of-period)								
Between loans and deposits in domestic currency	10.8	7.4	8.5	9.7	8.4	8.7	7.4	7.3
Between loans and deposits in foreign currency	0.8	2.0	4.0	3.2	3.5	5.0	4.1	3.0
Between loans in domestic and foreign currency	16.2	13.4	11.8	12.3	12.4	12.1	9.6	9.6
Between deposits in domestic and foreign currency	6.1	8.0	7.2	5.7	7.5	8.4	6.3	5.4
Number of banks not complying with banking regulations								
Not meeting capital adequacy requirements for Tier I capital 9/	29	19	17	11	17	11	5	10
Not meeting prudential regulations 9/	56	52	39	37	36	33	34	39
Not meeting reserve requirements	29	18	16	6	11	9	4	7

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

1/ Excludes banks under liquidation.

2/ Does not reflect the impact of the June 2016 Credit Risk Regulation, which became effective January 1, 2017.

3/ Monetary statistics data.

4/ NBU defines NPLs as loans classified as doubtful and loss.

5/ Includes also loans classified as substandard.

6/ Calculated according to IMF STA guidelines (i.e., sum of net open positions in foreign currencies).

7/ Net position calculated as on-balance sheet assets in foreign currency minus on-balance sheet liabilities in foreign currency.

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

9/ 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, 2015–25

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
	Actual		Projection								
Stock of existing and prospective Fund credit 1/ 2/3/											
In millions of SDRs	7,701	8,417	11,846	13,206	12,053	11,264	10,178	8,476	6,418	4,360	2,597
In percent of quota	561	418	589	656	599	560	506	421	319	217	129
In percent of GDP	11.9	13.1	16.7	17.3	14.3	12.2	10.1	7.7	5.0	3.2	1.8
In percent of exports of goods and services	22.5	25.5	31.9	33.4	28.4	24.6	20.9	16.4	11.6	7.4	4.1
In percent of gross reserves	81.0	75.3	71.3	58.6	53.4	49.2	43.0	34.7	28.1	21.7	14.8
Stock of existing Fund credit 1/ 2/3/											
In millions of SDRs	7,701	8,417	7,788	6,302	5,149	4,361	3,453	2,546	1,639	731	119
In percent of quota	561	418	387	313	256	217	172	127	81	36	6
In percent of GDP	11.9	13.1	11.0	8.3	6.1	4.7	3.4	2.3	1.3	0.5	0.1
In percent of exports of goods and services	22.5	25.5	21.0	15.9	12.1	9.5	7.1	4.9	3.0	1.2	0.2
In percent of gross reserves	81.0	75.3	46.9	28.0	22.8	19.1	14.6	10.4	7.2	3.6	0.7
Stock of prospective Fund credit 1/ 2/3/											
In millions of SDRs	0	0	4,058	6,904	6,904	6,904	6,724	5,930	4,779	3,628	2,478
In percent of quota	0	0	202	343	343	343	334	295	238	180	123
In percent of GDP	0.0	0.0	5.7	9.1	8.2	7.5	6.7	5.4	3.7	2.7	1.7
In percent of exports of goods and services	0.0	0.0	10.9	17.5	16.2	15.1	13.8	11.4	8.7	6.2	4.0
In percent of gross reserves	0.0	0.0	24.4	30.6	30.6	30.2	28.4	24.3	20.9	18.0	14.1
Obligations to the Fund from existing and prospective drawings 2/3/											
In millions of SDRs	125	0	881	1,822	1,515	1,161	1,423	1,984	2,261	2,175	1,810
In percent of quota	9	0	44	91	75	58	71	99	112	108	90
In percent of GDP	0.2	0.0	1.2	2.4	1.8	1.3	1.4	1.8	1.8	1.6	1.3
In percent of exports of goods and services	0.4	0.0	2.4	4.6	3.6	2.5	2.9	3.8	4.1	3.7	2.9
In percent of gross reserves	1.3	0.0	5.3	8.1	6.7	5.1	6.0	8.1	9.9	10.8	10.3
Obligations to the Fund from existing drawings 2/3/											
In millions of SDRs	125	0	788	1,540	1,099	661	758	781	826	876	614
In percent of quota	9	0	39	77	55	33	38	39	41	44	31
In percent of GDP	0.2	0.0	1.1	2.0	1.3	0.7	0.8	0.7	0.6	0.6	0.4
In percent of exports of goods and services	0.4	0.0	2.1	3.9	2.6	1.4	1.6	1.5	1.5	1.5	1.0
In percent of gross reserves	1.3	0.0	4.7	6.8	4.9	2.9	3.2	3.2	3.6	4.4	3.5
Obligations to the Fund from prospective drawings 2/3/											
In millions of SDRs	0	0	93	281	416	499	665	1,202	1,436	1,298	1,195
In percent of quota	0	0	5	14	21	25	33	60	71	65	59
In percent of GDP	0.0	0.0	0.1	0.4	0.5	0.5	0.7	1.1	1.1	1.0	0.8
In percent of exports of goods and services	0.0	0.0	0.3	0.7	1.0	1.1	1.4	2.3	2.6	2.2	1.9
In percent of gross reserves	0.0	0.0	0.6	1.2	1.8	2.2	2.8	4.9	6.3	6.5	6.8

Source: IMF staff estimates.

1/ End of period.

2/ Repayment schedule based on repurchase obligations and charges.

3/ For 2015 Ukraine's old quota of SDR 1,372 million applies. Ukraine's new quota of SDR 2,011.8 million became effective in February 2016.

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

	Amount of purchase			
Availability date	Millions of SDRs	Millions of US$ 1/	Percent of quota 2/	Conditions
March 11, 2015	3,546.00	4,872.00	258.45	Board approval of extended arrangement
June 15, 2015 3/	1,182.10	1,650.00	86.16	First review and end-March 2015 performance criteria
September 15, 2015 3/	716.11	999.80	35.60	Second review and end-December 2015 performance criteria
November 15, 2016	734.05	987.34	36.49	Third review and end-December 2016 performance criteria
May 15, 2017	1,418.48	1,906.91	70.51	Fourth review and end-March 2017 performance criteria
August 15, 2017	952.49	1,279.62	47.35	Fifth review and end-June 2017 performance criteria
November 15, 2017	952.49	1,278.81	47.35	Sixth review and end-September 2017 performance criteria
February 15, 2018	711.57	954.67	35.37	Seventh review and end-December 2017 performance criteria
May 15, 2018	711.57	954.58	35.37	Eighth review and end-March 2018 performance criteria
August 15, 2018	711.57	954.78	35.37	Ninth review and end-June 2018 performance criteria
November 15, 2018	711.57	955.15	35.37	Tenth review and end-September 2018 performance criteria
Total	12,348	16,794	614	

Source: IMF staff estimates.

1/ For 2015–18, the average USD/SDR rates used in this table are: 1.399, 1.396, 1.362, and 1.361, respectively.

2/ For 2015, Ukraine's previous quota of SDR 1,372 million applies. Ukraine's new quota of SDR 2,011.8 million became effective in February 2016. The total amount of SDR 12,348 million is equivalent to 614 percent of the new quota.

3/ The second purchase took place on August 4, 2015 and the third purchase took place on September 16, 2016.

Table 9. Ukraine: Spending Reforms

Spending area and objective	Lead agency	Problems	Recent Reforms	Pending Steps
Budget process Efficient and transparent budget process, and credible and predictable annual budgets	EU/IMF/WB	- Limited credibility and predictability of annual budgets - Absence of clear fiscal objectives and rules - Special treatment of certain "protected" items in the process of budget release - Limited coverage of the fiscal reporting - Different public sector entities applying different accounting policies - Financial audits of budget reports not entirely complying with international standards	- Amended the budget code by stipulating clear rules for supplemental budgets during its execution (December 2015) - Published state budget projections for 2018–19 as part of 2017 budget documents (September 2016) - Included a statement on quasi-fiscal operations as part of the draft 2017 budget documents (September 2016) - The Accounting Chamber of Ukraine received additional powers on the audit of the state budget revenues (April 2015)	- Create a reliable medium-term macro-fiscal framework for budget planning (December 2017) - Develop state strategic plan system (December 2017) - Complete spending reviews for a selected group of ministries based on minimum amount of savings to be identified (June 2017) - Amend the budget code to eliminate the distinction between protected and unprotected items (December 2017) - Consolidate statements for transactions on implementation of budgets of the state and social insurance funds (from 2018) - Update the strategy of public sector accounting reform (December 2017) - Strengthen the role of the minister of finance in the legislative process (2017) - Strengthen Accounting Chamber's capacity to conduct audits in line with international standards (2016–18)
Public administration A small, efficient public administration	EU	- Public administration that is inflated in size (with the public sector employment accounting for about 1/3 of total employment), inadequately paid, corruption-prone inefficient structures and procedures	- A new law on civil service adopted, implying a structural increase in civil service base salaries (December 2015), however, the civil servants' base salaries were de-linked from minimum subsistence (December 2016). - Cabinet of ministers approved a civil service reform strategy for 2016–20 (June 2016)	- Undertake a comprehensive review of the remuneration system of the public sector (June 2017) - Implement civil service reform strategy (2016–20) - Build a central civil service information system and start reporting the number of civil servants (June 2017) - Significantly downsize the public sector and raise salaries from efficiency gains (2017–20)
Public pensions Affordable, fair and equitable pension system	IMF/WB	- A large number of pensioners, low average pensions, special occupational treatment, low retirement age, high-structural deficit of the pension fund	- Tightened some early retirement opportunities (March 2015 and June 2016)	- Adopt a comprehensive pension reform that sets retirement options with a wider range of retirement ages than at present, dependent on total years of service, and with pension benefits that provide incentives for longer employment and later retirement (April 2017)

Table 9. Ukraine: Spending Reforms (continued)

Spending area and objective	Lead agency	Problems	Recent Reforms	Pending Steps
Social assistance Well-targeted, more coherent and sustainable social assistance	IMF/WB	- Poorly targeted and multiple social assistance benefits with significant leakage to high-income groups	- Streamlined the energy support programs, and updated the consumption norms for the subsidy program to bring them closer to current consumption levels (May 2016 and January 2017) - Improved targeting of social benefits for single mothers (January 2016)	- Revise parameters of the household utility subsidies and introduce an adjustment to the social norm for off-peak heating months (April 2017) - Continue strengthening the targeting of social assistance including by expanding the coverage of the Guaranteed Minimum Income program (2017–18) - Establish a single centralized database under the Ministry of Finance with all recipients of social assistance and their benefits (September 2017)
Healthcare Efficient, effective and well-targeted healthcare system with improved health outcomes	WB	- Poor health outcomes (Life expectancy is lower by four and nine years than in Eastern Europe and Central Asia (EECA) and European Union countries, respectively.) reflecting a misallocation of resources, with overstaffing, high out-of-pocket spending, and substantial room for improving efficiency and effectiveness of treatments	- Outsourced the procurement of pharmaceuticals to specialized international organizations (beginning of 2016) - Lowered the statutory limit on the number of hospital beds per 10 thousand residents to 60 from 80 (December 2015) - Cabinet approved the concept of healthcare financing (November 2016)	- Implement the new model of healthcare financing by moving from the system of per bed financing to medical insurance (2017–20).
Education Fiscally sustainable, efficient and equitable education system		- Low educational attainments; relatively high and inefficient public education spending reflecting extensive school network, low teaching hours and high level of employment at about eight student-teacher ratio, which is much lower than in other comparator countries	- Started school network optimization by closing small schools (2015) - Improved targeting of school lunch programs (December 2015)	- Continue reducing the school network, increase teaching hours to 20 hours per week in secondary schools, and cut administrative and teaching staff (2018–18)
Public investment Scaled-up public investment program with strengthened institutional framework	IMF	- Declining capital stock reflecting low and inefficient public investment (caused by the absence of a multi-annual budget framework and in particular the lack of a stable medium-term funding framework for public investments)	- The level of public investment was increased to above 3 percent of GDP in 2016, the highest since 2012 (Budget 2016)	- Strengthen planning and prioritization, improve resource allocation and develop comprehensive and efficient project implementation system (2016–18) - Strengthen coordination between central and subnational governments (2016–18)

Table 9. Ukraine: Spending Reforms (concluded)				
Spending area and objective	**Lead agency**	**Problems**	**Recent Reforms**	**Pending Steps**
Procurement of goods and services Efficient and corruption-free public procurement system		- Nontransparent and corruption-prone public procurement system	- Adopted amendments to procurement law that simplified the procurement process and increased transparency (September 2016) - Adopted e-procurement legislation that requires all government entities to use a new electronic procurement system from August 1, 2016 (December 2015)	- Bring Ukrainian procurement legislation and procedures in line with European Commission directives (2016–18)

Table 10. Ukraine: Revenue Administration Reforms

Objective	Problem	Progress to date	Next steps
Organization and governance: An independent and efficient revenue administration with strong oversight and accountability framework	- An overstaffed organization - An inefficient organization with outdated organizational structure - Nontransparent performance evaluation system, limited public accountability	- About 20 percent of staff has been cut as of mid-July 2016. - Number of legal entities at State Fiscal Service (SFS) tax branches was almost halved. - Executive Management Committee and Reform Management Offices were established at SFS. - The headquarters and oblasts have adopted modern structures with a partial implementation of functional-based model. - All companies meeting the criteria for large taxpayers are now registered with the Large Taxpayers' Office (LTO). - The audit function was partially centralized at the oblast level. - Ministry of Finance has established Key Performance Indicators (KPIs) for the SFS. - Some powers of the SFS head were delegated to lower-level officials in administering the main business process.	- Complete the targeted 30 percent downsizing of SFS - Merge tax and customs offices into a single legal entity and move to a fully function-based structure - Maintain audit functions at oblast level, while rayon-level offices perform only taxpayer functions - Reduce the number of inland custom clearance offices - Dissolve the tax police and establish a new civil service responsible for investigation of all economic crimes against the state. Preserve the existing internal anticorruption unit and establish a dedicated antifraud unit with the SFS. - Establish a clear oversight and accountability framework (including KPIs) as part of a performance agreement between the minister of finance and the head of SFS - Develop the SFS midterm reform strategy, building on the current institutional reform program - Complete an external audit of SFS' IT systems and databases - Find a solution for emergency funding of SFS IT risks
Integrity and transparency: Revenue administration that is service oriented and enjoys a high degree of public trust	- Public perception of corruption at SFS is extremely high.	- A new internal security department (ISD) responsible for fighting corruption within the SFS with fully vetted staff was established. - Vetting and reappointment of SFS staff started. - Regular public surveys of corruption perception of SFS has commenced. - In 2015, ISD investigated 540 cases of corruption resulting in 24 convicted individuals. In 2016, the ISD investigated 506 cases resulting in 26 convicted individuals. - In 2016, ISD developed and adopted new anticorruption program and code of conduct.	- Continue vetting, giving priority to the LTO, using the revised process agreed with the MOF. - Regularly communicate on the outcome of the vetting process with key stakeholders - Appoint staff based on a plan associated with financing options for compensation reform - Develop a sustainable compensation plan with MOF

Table 10. Ukraine: Revenue Administration Reforms (concluded)			
Objective	**Problem**	**Progress to date**	**Next steps**
Filing: Maintain an efficient and functioning tax return filing system	- Many late and stop filers, and high extent of paper filing	- Designated a unit responsible for filing compliance - Developed a proactive filing compliance enforcement program that includes outbound call capability and electronic reminders of filing dates - A number of electronic filing services were developed, including the implementation of the new electronic VAT administration system	- Increase the incidence of electronic filing of tax declarations
Compliance and audit: Revenue administration encourages voluntary compliance and has adequate powers and tools to detect tax evasion	- Large administrative burden on taxpayers - Limited audit powers - Unbalanced audit program with a large share of unplanned audits	- One-stop shop service at customs has been put in place from August 1, 2016 at all customs checkpoints - Audit program was rebalanced to increase the number of risk-based planned audits while reducing unplanned audit activities - SFS reviewed management of largest debtors and assigned the cases to a separate function in LTO. - The appeals function at headquarters was separated into a new independent and dedicated department on central level directly reporting to the SFS head. - VAT refund register was implemented and published to improve transparency of VAT refunds. - Customs mobile groups targeting customs fraud and smuggling were created in cooperation with four law enforcement agencies. - An Inter-Regional Customs Office is being created to increase the service and control aspects at border crossing points. - Progress has been achieved in further developing the risk management framework in the customs.	- Introduce a one-level internal dispute resolution system - Harmonize the bases for social security contributions (SSCs) and personal income tax (PIT), offer the possibility of single filing and payment and unify penalty systems - Develop a framework for modern compliance management for PIT and social security contributions and implement a compliance improvement program. - Establish post-clearance audit program for the customs - Adopt legislation to authorize the SFS to use indirect audit methods and to provide SFS with access to bank account information with appropriate safeguards. - Establish criteria for the identification of High Net Worth Individuals (HNWIs) and audit them - Amend the legislation to remove the restrictions on the frequency of audits - Create a unified customs value reference database at the SFS
Tax collection: Reduce the level of collectible unpaid arrears	- Relative high and rising volume of tax arrears exceeding 2½ percent of GDP as of July 1, 2016	- Limited progress	- Adopt draft legislation that allows to strengthen the administrative enforcement of debt collection

Annex I. Implementation Status of the 2013 Article IV Recommendations

Areas	Recommendation	Current Status
Monetary and Exchange Rate Policies	Allow the exchange rate to adjust to its equilibrium level and increase its flexibility thereafter	The NBU abandoned its *de facto* exchange rate peg and switched to a flexible exchange rate regime in February 2014. Since then, the NBU has limited foreign exchange intervention (sales) to offset excessive volatility.
	Adopt changes in the National Bank of Ukraine (NBU) monetary policy framework and in the medium-term adopt inflation targeting (IT). Remove FX restrictions.	After floating the exchange rate, the NBU adopted an interest rate based monetary policy framework with targets for the NBU's net domestic assets and net international reserves, and instituted reforms to transition to IT. However, due to the crisis, FX restrictions needed to be tightened further. Since May 2015, the NBU has adopted a condition-based roadmap to phase out the FX restrictions. Further, the NBU formally adopted an inflation-targeting framework in December 2016.
Financial Sector Polices	Strengthen the banking system resilience to shocks, including launching independent diagnostic audits of vulnerable systemic banks; allowing all banks to reduce their negative foreign exposure and removing impediments to non-performing loan resolution.	Significant progress has been made in cleaning up the banking system (with more than 80 banks closed). Along with stronger powers to supervise related-party lending, bank diagnostics were an important tool in the resolution and recapitalization of many of the largest banks, including nationalization of PrivatBank. Repeal of Resolution 109 allowed for the reduction of banks' large negative FX positions, while the NBU also strengthened other prudential requirements (importantly on credit risk provisioning). However, progress on removing impediments to NPL resolution require further tax and legal reforms.

Areas	Recommendation	Current Status
Fiscal Policies	Pursue a sizeable current expenditure-based fiscal consolidation to curtail the budget deficit and make room for higher public investment. Limit the amount of government guarantees to below 1 percent of GDP per year.	The combined deficit of the general government and Naftogaz has been reduced from 10 percent of GDP in 2014 to 2.4 percent in 2016. Issuance of new guarantees is being limited to less than ¾ percent of GDP per year since 2015.
Energy Sector Reforms	Comprehensive energy sector reform focused on eliminating Naftogaz's operational losses.	Gas and heating tariffs reached full cost recovery levels in July 2016. Naftogaz's deficit has now almost been eliminated.
	Increase targeted social assistance to the poorest 40 percent of households	Energy-related social assistance programs have been significantly expanded with about half of households receive utility subsidies, suggesting the need for better targeting.
Structural Reforms	Improve the business climate to support higher growth	Little progress has been made in SOE reform or improving the business environment as a piecemeal approach to these reforms has failed to generate momentum.

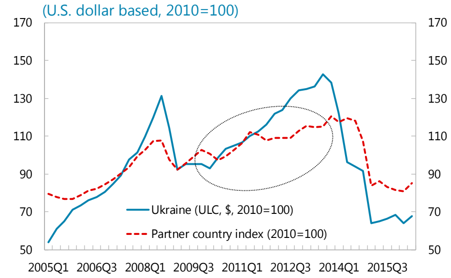
Annex II. Competitiveness, Exchange Rate and Reserve Adequacy Assessment

Staff's overall assessment is that Ukraine's external position in 2016 was broadly in line with fundamentals, especially when taking into account the need for Ukraine to improve its deeply negative net international investment position (NIIP) and its low level of reserves. Competitiveness has improved markedly following the large depreciation of 2014–15. This, however, helped only to contain a larger contraction of exports following the contemporaneous negative shocks to production capacity due to the conflict in the East and worsening terms of trade. The policy assumptions underpinning this assessment hinge upon the timely and continued implementation of the program. Reserves are low, with reserve adequacy expected to be reached by end-2018 only. Possible capital flight as capital controls are prematurely removed, further negative terms of trade shocks, together with a further escalation of the conflict pose significant risks.

Real Exchange Rate

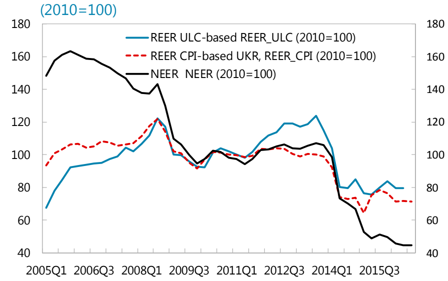
1. Ukraine's competitiveness has been boosted following the move to a flexible exchange rate in early 2014, but wage pressures pose risks that this is gradually reversed. The strong overvaluation during 2009–13 driven by high labor cost increases as compared to trading partners has been followed by a large correction with the devaluation in 2014 and continued depreciation through 2015 and 2016. The nominal exchange rate *vis-a-vis* the U.S. dollar depreciated by 50 percent by the end of 2014 as compared to 2013 and another 80 percent in the following year. This, combined with wage restraint, led to a correction in the real effective exchange rate (REER) and a boost in competitiveness with both United Labor Cost (ULC)- and Consumer Price Index (CPI)-based REER staying below 2009 levels. With inflation averaging about 25 percent during 2014–16, real wages also declined by a cumulative 17 percent during this period. The improvement in competitiveness, however, only helped to contain the contraction in exports as a result of multiple concurrent negative supply and demand shocks to the economy, such as the conflict in the East combined with a loss in production capacity and investor confidence, low commodity

ULC
(U.S. dollar based, 2010=100)



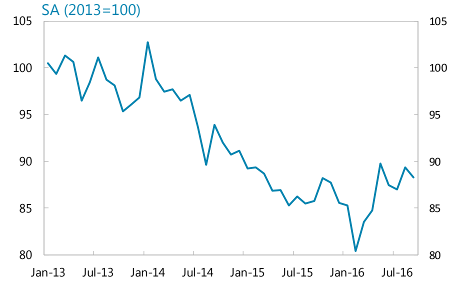
Sources: Haver, National Bank of Ukraine, and IMF staff calculations.

Effective Exchange Rates
(2010=100)



Sources: Haver, National Bank of Ukraine, and IMF staff calculations.

Terms of Trade Index
SA (2013=100)



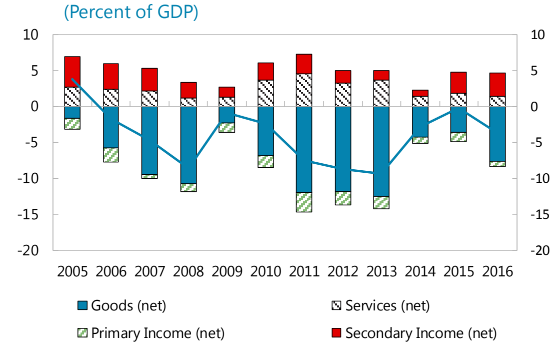
Sources: Haver, National Bank of Ukraine, and IMF staff calculations.

prices for Ukraine's main exports, trade restrictions as well as higher operating costs for exporters due to the large depreciation that ensued. Exports contracted by an average of 22 percent over 2014–15 and a further 5 percent in 2016. *As the nominal exchange rate has stabilized and inflation is coming down quickly, containing wage pressures in line with productivity will be important to maintain competitiveness gains. In this respect the recent doubling of the minimum wage threatens to reverse some of the competitiveness gains. The negative impact of a higher minimum wage on competiveness could be contained to the degree that i) collective agreements in the private sector do not lead to automatically higher wages for non-minimum wage workers, ii) the higher domestic demand leads to higher inflation and hence some nominal depreciation as well as the fact that in the main export sectors such as commodities and agriculture products, Ukraine is considered to be a price taker. Overall, under these assumptions staff expects that the higher minimum wage will not lead to significant real appreciation going forward.*

2. The crisis also marked a structural break in trade relations. The difficulties with Ukraine's main trading partner, Russia, has resulted in significant trade restrictions such as an embargo and transit ban for exports to other Commonwealth of Independent States (CIS) countries. These trade restrictions, while maybe not permanent, have caused a structural shift in the composition of trading partners which is expected to last. As shown in the selected external indicator figure in the staff report, export shares of CIS countries have dropped by about 20 percentage points in favor of larger shares of Europe and Emerging Asia. This will also imply a shift in the structure of products as the key exports to CIS countries are machinery and equipment while exports to Europe are mainly agriculture products. The Free Trade Agreement (FTA) agreement with the European Union that came into power in January 2016 is expected to facilitate the re-direction of trade towards European markets. *Going forward what will determine the new equilibrium and its sustainability will depend on the ability to adapt to a structurally different trade environment by adjusting production for new markets.*

3. The current account has corrected sharply following the early 2014 crisis, to a deficit of about 3.8 percent in 2016. Following an average deficit of 8 percent of GDP during 2011–13, the current count was broadly balanced in 2015. This sharp correction was driven by the compression in imports, which declined by 30 percent reflecting the decline in real income, large devaluation and trade measures such as a temporary import duty surcharge during 2015. The ban on

Current Account Components
(Percent of GDP)



Sources: Haver, National Bank of Ukraine, and IMF staff calculations.

dividend repatriation as part of the capital controls instituted in 2014 was an additional temporary factor which contributed to the almost balanced current account. In 2016, the current account deficit increased to 3.8 percent of GDP as import growth resumed (driven by demand for machinery and equipment) and the repatriation of dividends was relaxed.

4. **Under the baseline of continued program implementation, staff assesses the external position to be broadly in line with fundamentals**. The current account (CA) model points to a *slight undervaluation of the hryvnia* of about 5 percent, within the range of an external position in line with fundamentals.[1] The external sustainability model also points to a similar undervaluation ranging from 8 percent when stabilizing the NIIP at the current level of about 60 percent of GDP or an undervaluation of under 3 percent when targeting an NIIP of 50 percent for the next 10 years. The effective exchange rate index model on the other hand points to a larger undervaluation of 24 percent. However, in this method historical structural breaks undermine the robustness of the results.

EBA-Lite Results, 2016 1/

(percent of GDP)

EBA-lite CA model			
Standard version			
Actual CA	-3.8		
Cyclically adjusted CA	-3.5		
CA norm	-5.8		
Cyclically adjusted CA norm	-5.5		
CA gap	2.0		
o/w policy gap	2.1		
Elasticity	-0.3		
REER gap	-4.9		
EBA-Lite External Sustainability Model			
IIP stabilization at 2016 level -60 percent of GDP		IIP stabilization at - 50 percent of GDP within 10 years	
Underlying CA	-2.8	Underlying CA	-2.8
CA norm	-5.4	CA norm	-3.6
CA gap	2.6	CA gap	0.9
REER gap	-8.1	REER gap	-2.7
EBA-Lite REER model			
REER gap	-23.9		

Source: IMF staff estimates.

1/ Estimates are based on full capital controls.

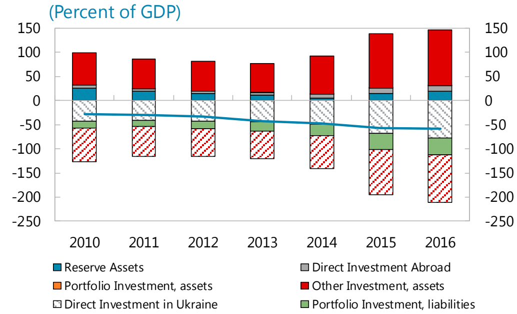
Foreign Asset and Liability Position

5. **Ukraine's weak international investment position has continued to deteriorate**. Owing to the large current account deficit during 2011–13, the NIIP deteriorated by 13 pp of GDP during this period from -30 to -43 percent of GDP. Following with the onset of the February 2014 crisis with

[1] This range is between -5 and 5 percent.

the current account deficit averaging at about 2 percent of GDP during 2014–15 and imposed capital controls, the NIIP's continued deterioration was on the back of valuation changes. As of end-2016, the NIIP stood at -59 percent of GDP and *going forward it is expected to reach to about -50 percent of GDP. As the non-financial sector maintains significant currency assets abroad (93 percent of GDP by end-2016) this reduces their exposure to external shocks and helps maintain external debt service.*

Net International Investment Position
(Percent of GDP)

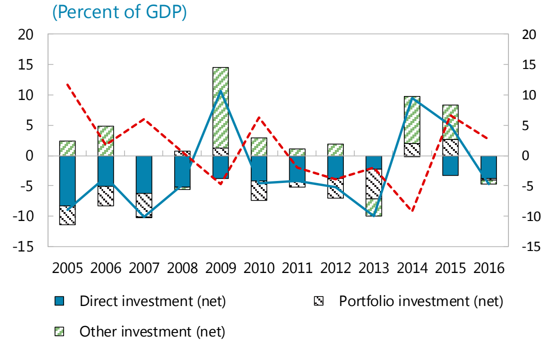


Sources: Haver, National Bank of Ukraine, and IMF staff calculations.

Capital and Financial Account Flows and Policy Measures

6. The capital outflow during 2014 declined in 2015 and 2016, which combined with significant external official financing contributed to more than a doubling of reserves. The sharp capital outflows in both other investment and portfolio flows in 2014 as the crisis was unfolding, declined significantly in 2015–16. Net inflows of foreign direct investment (FDI) that ensued in 2015–16 were mostly directed at the banking sector as debt-to-equity or debt forgiveness operations between subsidiaries and parent banks. Following the sharp decline in reserves in 2014, reserves again increased in 2015–16, reaching US$15.5 billion by end-2016. *Looking ahead, important policy changes that will affect capital flows include the gradual removal of capital controls introduced in 2014. Their relaxation is based on a conditions-based approach and while higher capital outflows can be expected following a relaxation, they are likely to facilitate higher FDI inflows and market access.*

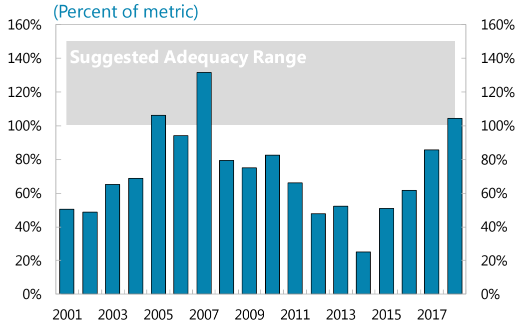
Capital Flows
(Percent of GDP)



Sources: Haver, National Bank of Ukraine, and IMF staff calculations.

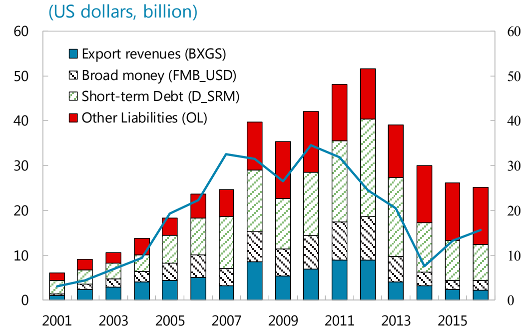
7. However, Ukraine's gross international reserves (GIRs) are still far from an adequate level. Ukraine's gross reserves declined sharply in 2014 to a level of US$7.5 billion, covering only two months of imports and 20 percent of short-term debt. In terms of the composite IMF metric, reserve coverage stood at 25 percent far below the recommended range of 100–150. The current account correction, capital controls and external official financing led to a pickup in reserves to more than double this amount by end of 2016 reaching 62 percent of the composite metric. This is still significantly below the recommended range as well as the lowest among its peers. At the current state, reserves cover less than four months of imports of goods and services and only 59 percent of short debt thus raising concerns of rollover risk and capital flight. *Going forward, while private capital inflows are not expected to pick up soon, official external financing and some market access under the program should increase gross reserves to above 100 percent of the IMF metric by 2018. Risks associated with weak program implementation, depreciation pressures, limited capital market access and premature relaxation of capital controls can endanger the rebuilding of the reserve position.*

Reserves
(Percent of metric)



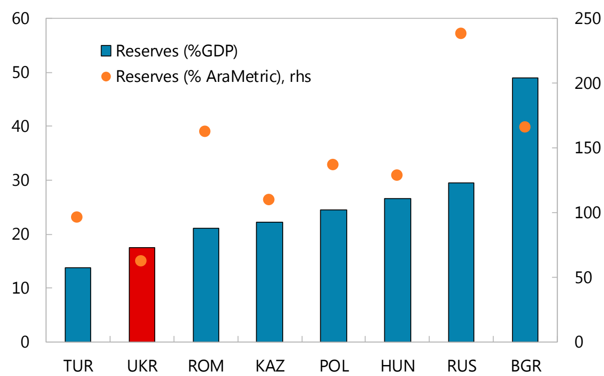
Sources: Haver, National Bank of Ukraine, and IMF staff calculations.

ARA Metric Decomposition
(US dollars, billion)



Sources: Haver, National Bank of Ukraine, and IMF staff calculations.

Reserve Metric, Selected Countries, 2016



Sources: Haver, National Bank of Ukraine, and IMF staff calculations.

Reserve Adequacy Metrics, 2010–21

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Gross official reserves (billions of U.S. dollars)	34.6	31.8	24.5	20.4	7.5	13.3	15.5	22.3	30.2	30.3	30.7	31.8
Months of imports of goods and services	4.2	3.7	3.0	3.5	1.8	3.3	3.5	4.7	5.9	5.5	5.2	5.0
Percent of short-term debt at remaining maturity	74.8	57.4	40.0	35.2	20.5	48.7	59.2	79.7	94.6	86.3	85.2	83.7
Percent of IMF composite measure 1/	95.9	79.2	56.8	45.0	25.1	51.2	62.2	83.9	105.3	102.7	102.0	102.9

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

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

Annex III. Debt Sustainability Analysis

Under the policy and financing package supporting the authorities' program, including the recent completion of the debt operation as per terms consistent with program targets, and conditional to no material intensification of the conflict in the East, Ukraine's public debt is assessed as sustainable with high probability. Debt has embarked on a path to fall below 70 percent of GDP by 2021—assuming the fiscal consolidation achieved to date is sustained, including no reemergence of quasi-fiscal losses in the energy sector, successful completion of the debt operation with bilateral creditors, growth recovery, privatization, and real exchange rate appreciation. The projected downward trajectory of Ukraine's public debt remains subject to considerable risks, particularly from growth and real exchange rate shocks, or failure to sustain the programmed fiscal adjustment. The average gross financing needs during the program and post-program period are forecast to remain well below 15 percent of GDP, 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 Debt Sustainability Analysis (DSA) continues pointing to significant solvency concerns as external debt stood at 129 percent of GDP in 2016, with the historical scenario showing unsustainable dynamics. The presence of significant non-financial foreign assets provides a buffer for maintaining external debt service while a sustained reduction in current account deficits would put external debt on a downward path, mitigating risks to public debt sustainability.

1. **This annex 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 with respect to the EFF second review projections. 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 considerable 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**.

- *Real GDP growth*. Growth is projected to reach 2.9 percent in 2017, slightly higher compared to the second review and thereafter reaching 4 percent by 2020.

- *Exchange rate*. The average exchange rate stood at 25.5 in 2016, slightly more appreciated than at the time of the second review. It is expected that relatively contained current account deficits and the resumption of capital inflows would support a small real exchange rate appreciation over the medium term.

- *Inflation*. Inflation (measured by the GDP deflator) declined to 13 percent in 2016, 0.5 percentage points lower than projected at the time of the second review in light of weaker terms of trade. As economic stabilization takes hold, inflation is expected to gradually decrease to 12 percent in 2017 and to about 6 percent over the medium term.

- *Fiscal and Naftogaz deficits*. On the back of the fiscal over-performance in 2016, the combined fiscal deficit for 2016 stood at 2.4 percent of GDP, 1.5 percentage points lower than the deficit envisaged at the time of the second review. In 2017, the combined deficit is expected to reach 3.1 percent of GDP as envisaged at the time of the second review. The cyclically-adjusted primary surplus of the general government is projected to remain from 2017, onwards at 1.8 percent of potential GDP, representing an adjustment of around 4 percentage points of GDP over 2013. As noted before, this path is ambitious in the context of underlying spending pressures and previous fiscal performance in Ukraine (an average cyclically adjusted primary deficit of 0.6 percent of GDP over 2006–16), 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. Other identified debt-creating/reducing flows.

- *Banking system support*. Fiscal costs for 2016 and 2017 stand at about 5.7 and 3.7 percent of GDP, respectively, with total costs higher by some ½ percent of GDP compared to the second review, and about 1.5 percent of GDP in financing shifted from 2016 to 2017.

- *Naftogaz recapitalization*. In line with the second review, no more fiscal support to Naftogaz is envisaged during the medium term for operational and investment purposes. However, the program continues to assume that Naftogaz would need an additional 2 percent of GDP of financing support to clear the stock of arrears with Gazprom in 2017.[1]

- *Issuance of guaranteed debt*. For 2016, about 0.7 percent of GDP was issued in the form of guarantees. In 2017, the program assumes that the issuance of new guarantees would remain at

[1] Actual repayment will depend on the decision of the Stockholm arbitrage tribunal. These arrears are disputed by Naftogaz at present.

0.6 percent of GDP, and limited to 0.3 percent of GDP per year from 2018 onwards due to the expected reduced demand brought about by the privatization/corporatization of state-owned enterprises (SOE).

- *Privatization proceeds*. For the period 2017–22, the program assumes an average of 0.5 percent of GDP per year, below the historical average of 0.9 percent during 2006–16. Risks remain, however, high given the delays in implementing the privatization agenda.[2]

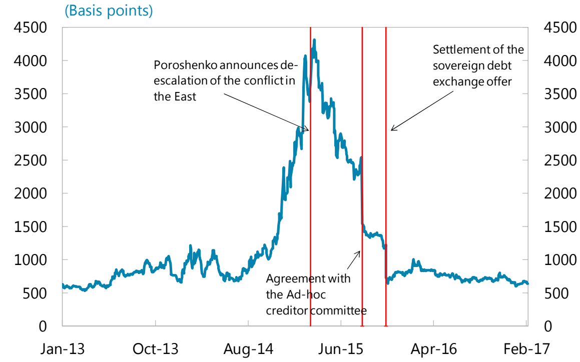
4. Debt operation. The authorities have successfully completed the restructuring of nearly all external liabilities included in the perimeter of the debt operation in line with the financing and debt objectives of the program. This included public and publicly guaranteed debt (sovereign and sovereign-guaranteed Eurobonds, city of Kyiv Eurobonds, and guaranteed commercial loans) and SOE debt (non-guaranteed Eurobonds and loans) for a total nominal value of US$19.3 billion. As discussed in detail in the Public DSA Annex of the second review, this restructuring aimed at contributing to financing and debt targets to enable a higher probability of debt sustainability. With respect to the Russian-held bond of US$3 billion, good-faith efforts continue aiming to complete the restructuring consistent with the parameters of the program. The first hearing of the ongoing litigation in UK court took place in January 2017, but the judgment is pending. In parallel, the two countries are seeking a restructuring agreement. Similar to the second review, the DSA assumes that a restructuring agreement would be reached involving no nominal haircut and a repayment schedule and coupon rate consistent with the financing and debt objectives of the program.

5. Official financing. Multilateral and bilateral financing is provided at concessional rates (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 a grace period of about five years). IMF lending under the current program is calibrated to be on EFF terms.

[2] The authorities remain committed to the privatization of PJSC Odessa Portside Plant by the first half of 2017. In parallel, they plan to initiate the privatization of a number of large SOEs identified for privatization by end-September 2017: PJSC Centrenergo, Turboatom, whose shares will be immediately transferred to the State Property Fund of Ukraine (SPFU), and the regional energy distribution companies, obloenergos.

6. **Market access**. Evidence points to an early return to market access in past successful preemptive debt operations, with time to re-access at about three years from the start of the operation.[3] Ukraine's time to re-access markets after its 1998 debt restructuring was also about three years. It is then expected that in 2017 Ukraine would be able to re-access international capital markets (five-year bonds at a yield of 9 percent), supported by the improved debt profile as a result of the debt operation (reflected in the notable reduction in sovereign risk to pre-crisis levels) and assuming a continued de-escalation of the conflict in the East. Low gross financing needs during the post-program period, well below the high-risk benchmark in the debt sustainability framework, would help ensure the needed continuous market access.

EMBI Global, Spread
(Basis points)



Source: Bloomberg.

B. Public Sector DSA

7. **The coverage of public debt in this DSA includes**: (i) central government direct debt; (ii) domestic and external government-guaranteed debt (loans and bonds) extended to SOEs; (iii) debt of local governments; and (iv) Ukraine's liabilities to the IMF that are not included in central government direct debt. It does not contain non-guaranteed SOEs' domestic and external liabilities.

Public and Publicly Guaranteed Debt, 2016

	UAH (Billion)	USD (Billion)	Percent of GDP	Percent of Total
Public and publicly guaranteed debt	1,936	71.2	84.9	100.0
Domestic debt	693	25.5	30.4	35.8
Direct debt in UAH	569	20.9	24.9	29.4
Direct debt in FX	106	3.9	4.6	5.5
Guaranteed debt	19	0.7	0.8	1.0
External debt	1,243	45.7	54.5	64.2
External direct debt	983	36.2	43.1	50.8
Multilateral 1/	354	13.0	15.5	18.3
of which: IMF budget support	186	6.8	8.2	9.6
Bilateral 2/	108	4.0	4.8	5.6
Sovereign Eurobonds	518	19.0	22.7	26.7
Local government Eurobonds 3/	3	0.1	0.1	0.1
External guaranteed debt	260	9.5	11.4	13.4
of which: IMF loans to NBU	170	6.3	7.5	8.8
of which: Eurobonds	0	0.0	0.0	0.0
of which: Commercial loans	57	2.1	2.5	3.0

Sources: Ministry of Finance of Ukraine
1/ Includes IMF, World Bank, EBRD, EIB.
2/ Includes EU.
3/ Issued by the city of Kyiv.

[3] International Monetary Fund, 2014, "The Fund's Lending Framework and Sovereign Debt—Annexes."

8. Baseline projections indicate that the debt ratio would fall below 70 percent of GDP by 2021 (Figure 3). Debt stood at about 85 percent of GDP at end-2016, a jump of about 5 percentage points from 2015 driven mainly by the financial sector support and depreciation. The increase in debt was contained as compared to the second review by the fiscal over-performance, delayed IFI disbursements as well as due to shift of bank recapitalization costs to 2017, and reduced issuance of new guarantees. Debt is expected to peak in 2017 due to a catch up of IFI disbursements and further bank recapitalization costs. Thereafter, sustained fiscal adjustment and growth recovery (as well as real exchange rate appreciation and privatization receipts) would underpin the gradual convergence of debt to below 70 percent of GDP by 2021.

9. A heat map and fan charts indicate that Ukraine faces significant risks to debt sustainability (Figure 1). Even after assuming the successful completion of the debt operation and assuming full program implementation, significant uncertainty remains, heightened by a sudden deterioration of the external environment. However, risks stemming from the elevated debt level are mitigated by reduced gross financing needs, projected to average 11 percent during 2017–18 and 10 percent after the program period. 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 limits of fiscal effort over what is envisaged under the baseline 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 have improved. While still high, the EMBIG spread has come down from its peak of 4,312 basis points in 2015:Q1 to an average of about 651 basis points by mid-February 2017, reflecting the reduction in external and internal imbalances, the de-escalation of the conflict in the East and the successful completion of the debt operation with private creditors (see text chart). The share of public debt held by nonresidents is high (2/3 of total debt), but the shift from private to official creditors is reducing the implied risks. Short-term debt ratios are very low, and the share of foreign currency debt is projected to decline in the coming years, mitigating rollover and exchange rate risks.

10. Stress tests continue pointing to a number of considerable risks to the debt outlook, with the balance of risk mostly tilted to the downside, but the probability of some of the events is assessed to be low. 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 lower growth by one historical standard deviation in 2018–19 (to -4 percent and -3.6 percent, respectively), which leads in turn to sizable deteriorations of the primary balance to deficits of 1.7 and 5.7 percent of GDP, respectively, the debt-to-GDP ratio reaches 105 percent in 2019. However, given the very deep recession in 2014/15, there is scope for some economic recovery in the medium term. A real exchange rate shock replicating half the size of the FX pressures Ukraine experienced in 2014 (with the nominal exchange rate moving from 27 UAH/USD in 2016 to 48 in 2018) would push the debt ratio to 109 percent of GDP by 2018. This risk is, however, mitigated as the exchange rate is assessed to be slightly undervalued. The combined macro-fiscal shock, an aggregation of the shocks to real growth, interest rate, primary balance and exchange rate, produces unsustainable dynamics, sending debt to almost 150 percent of GDP in 2019. The contingent liabilities shock highlights the risk of a further deterioration of banking sector health and associated higher fiscal costs. Its impact is mitigated by the nationalization of PrivatBank and the program buffer embedded under the baseline for bank restructuring and resolution costs. By imposing a large associated shock to growth (10 percentage points below the baseline in 2018–19) and given the resulting deterioration in the primary balance together with an increase in interest rates, under the contingent liabilities shock debt peaks at 100 percent of GDP in 2019. A scenario based on Ukraine's historical variables (with flat growth and primary deficit at -1.3 and 0.7 percent, respectively) leaves debt very high and flat at about 92 percent of GDP. However, the implementation of the EFF-supported program, especially the structural reforms to facilitate growth recovery and sustain the current fiscal adjustment, should prevent this from occurring.

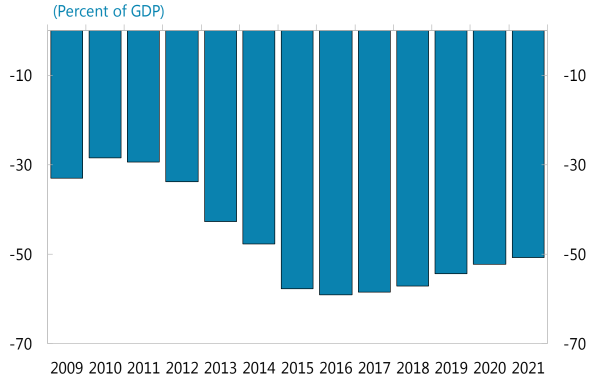
11. The shock scenarios point to risks related to larger-than-expected financing needs, including to support the banking sector. However, under the baseline, owing to the 2016 fiscal over-performance, 2016 gross financing needs have declined to the extent that the heat map points to low to moderate liquidity risks compared to the high risks at the time of the first and second review, and have been fully covered. Under stress tests, only the combined shock has a substantial impact on gross financing needs, raising these to an average of more than 20 percent of GDP during the projection period.

12. While there are considerable risks surrounding the sustainability of public debt, there are also mitigating factors. These include reduced gross financing needs following the debt restructuring, an increase in the share of official debt and a decline in foreign currency debt, as well as a very low share of short-term debt. Financial sector risks have considerably diminished with the nationalization of the largest bank.

C. External Sector DSA

13. Baseline projections suggest that external debt would drop by about 50 percentage points of GDP by 2021, while remaining high. Gross external debt is estimated to have declined slightly to 129 percent of GDP in 2016 from 131 percent in 2015 and it is expected to decline further to about 95 percent of GDP by end-2021. 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 9 percent of GDP in 2013 to about 4 percent by 2021. Its downward path is also supported by the impact of the debt operation through the primary income balance in the current account and the expected sustained recovery of non-debt creating capital inflows. Moreover, the non-financial sector maintains significant foreign currency assets (at 93 percent of GDP by end-2016, see the net international investment position (NIIP) text table below), which reduces their net exposure to external shocks and helps maintain external debt service. The latter is reflected in the significant difference between external debt and the NIIP, with the latter projected to improve from -59 percent of GDP in 2016 to close to -50 percent in the medium term.

Net International Investment Position
(Percent of GDP)



Source: IMF staff calculations.

Net IIP, 2016
(Percent of GDP)

Net IIP	-59
Assets	139
FDI	11
Portfolio	0
Other investment	110
Reserve assets	17
Liabilities	198
FDI	72
Portfolio	35
Other investment	91
Memo:	
Liquid financial sector assets	8
Liquid non-financial sector assets	93

Source: IMF staff calculations.

14. 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, delays in finding suitable markets for products previously targeted to CIS trading partners, and/or the sudden worsening of the external environment 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 about 1.5 percent of GDP per year compared to the baseline, the external debt ratio would increase by about 9 percent of GDP by 2021. External debt dynamics are significantly affected by growth shocks. A half historical standard deviation shock from the growth path under the baseline, about 3 percentage points lower growth on average per year, increases the external debt ratio by about 20 percentage points of GDP by 2021. FDI flows during 2014–16 have been mainly in the form of debt-to-equity operations. Looking ahead, a slower resumption of non-bank related FDI from a prolongation or intensification of the conflict in the East as well as delays in privatization efforts would also significantly affect external debt dynamics, with a sizable upward shift in the debt adjustment path. The historical scenario, with main macro variables constant at their 10-year historical average, generates unsustainable dynamics. The latter is the result of a permanent state of recession (with real GDP contracting 0.8 percent per year) and significant and sustained FX pressures (with the GDP deflator in U.S. dollar terms flat at just 2.9 percent). It thus remains critical to accelerate the reform process to enhance the business climate and non-price competitiveness in order to attract the needed FDI to support growth and expand and diversify the export base.

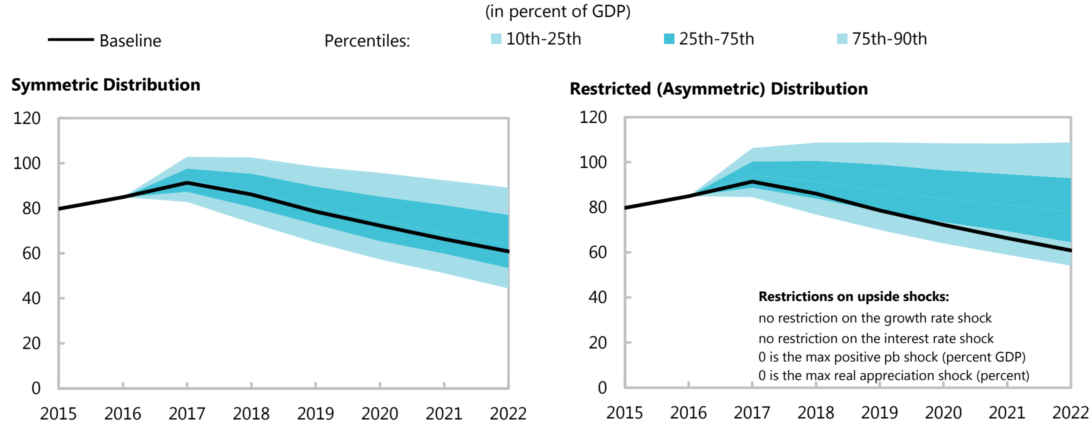
Annex III. Figure 1. Ukraine: Public DSA Risk Assessment

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

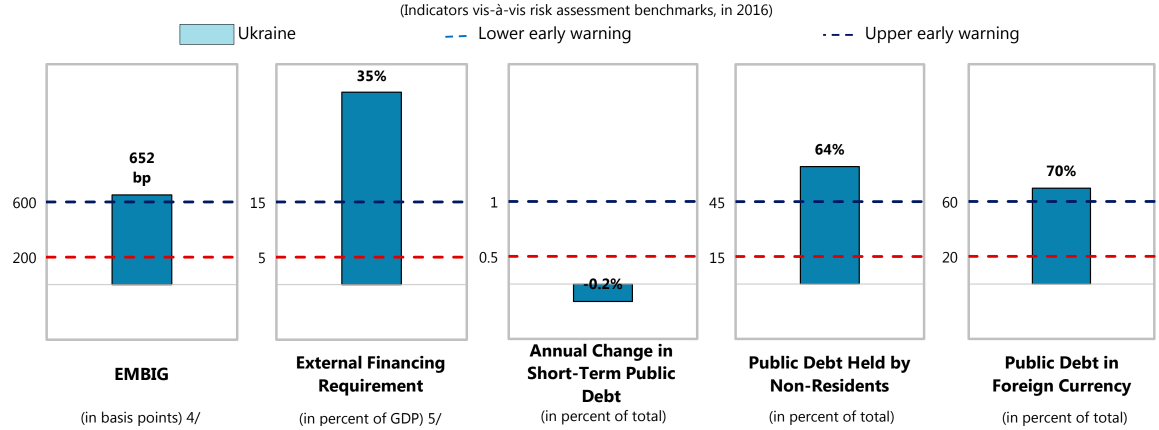
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2016)



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.

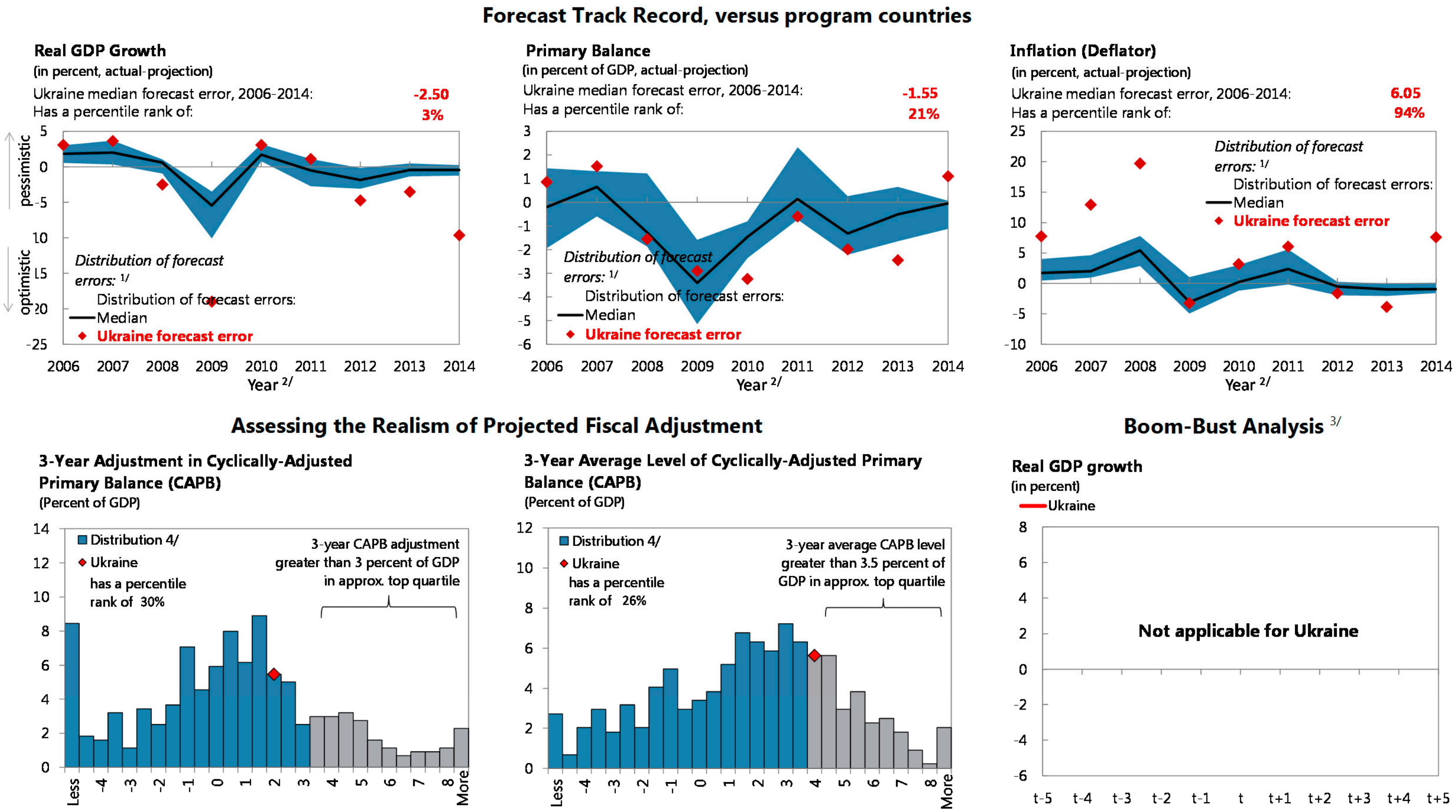
Lower and upper risk-assessment benchmarks are:

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, 15-Nov-16 through 13-Feb-17.

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.

Annex III. Figure 2. Ukraine: Public DSA—Realism of Baseline Assumptions



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 obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Annex III. Figure 3. Ukraine: Public DSA—Baseline Scenario

(in percent of GDP unless otherwise indicated)

(in percent of GDP unless otherwise indicated)

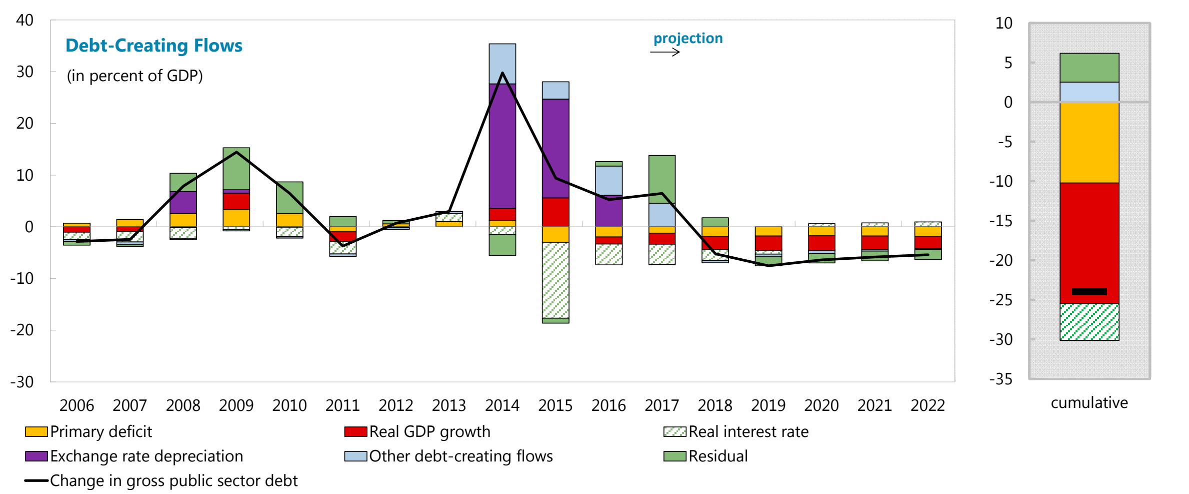
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2006-2014 [2/]	2015	2016	2017	2018	2019	2020	2021	2022
Nominal gross public debt	34.0	79.7	84.9	91.4	86.2	78.6	72.2	66.4	61.0
Of which: guarantees	7.2	12.0	12.2	17.5	18.1	15.9	13.9	11.5	9.3
Public gross financing needs	7.4	11.7	12.8	12.7	9.9	12.1	11.1	8.7	7.8
Real GDP growth (in percent)	0.3	-9.9	2.0	2.9	3.1	3.5	4.0	4.0	4.0
Inflation (GDP deflator, in percent)	15.0	38.4	13.0	12.0	9.0	7.5	6.0	6.0	6.0
Nominal GDP growth (in percent)	15.5	24.7	15.2	15.2	12.5	11.4	10.2	10.3	10.2
Effective interest rate (in percent) [4/]	7.6	8.6	7.3	6.9	6.7	6.8	7.1	7.4	7.8

As of February 13, 2017		
Sovereign Spreads		
EMBIG (bp) 3/		643
5Y CDS (bp)		621
Ratings	Foreign	Local
Moody's	Caa3	Caa3
S&Ps	B-	B-
Fitch	B-	B-

Contribution to Changes in Public Debt

	Actual			Projections							
	2006-2014	2015	2016	2017	2018	2019	2020	2021	2022	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	5.9	9.4	5.2	6.4	-5.2	-7.5	-6.4	-5.9	-5.4	-24.0	
Identified debt-creating flows	4.2	10.3	4.4	-2.8	-7.0	-5.8	-4.6	-3.9	-3.5	-27.6	
Primary deficit	1.4	-3.0	-2.0	-1.2	-1.8	-1.8	-1.8	-1.8	-1.8	-10.2	-1.3
Primary (noninterest) revenue and grants	42.2	42.1	40.1	40.5	40.6	40.5	40.4	40.0	39.5	241.5	
Primary (noninterest) expenditure	43.5	39.1	38.1	39.3	38.7	38.7	38.6	38.2	37.7	231.2	
Automatic debt dynamics [5/]	2.2	10.0	0.7	-6.1	-4.7	-3.5	-2.2	-1.9	-1.5	-19.9	
Interest rate/growth differential [6/]	-1.0	-9.1	-5.4	-6.1	-4.7	-3.5	-2.2	-1.9	-1.5	-19.9	
Of which: real interest rate	-1.2	-14.7	-4.1	-4.0	-2.1	-0.8	0.6	0.7	0.9	-4.6	
Of which: real GDP growth	0.2	5.6	-1.4	-2.1	-2.6	-2.7	-2.8	-2.6	-2.4	-15.3	
Exchange rate depreciation [7/]	3.2	19.1	6.1	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.6	3.3	5.6	4.6	-0.5	-0.5	-0.6	-0.3	-0.1	2.5	
General government financing: Domestic (net): Priv	-0.5	-0.5	0.0	-0.7	-0.5	-0.5	-0.5	-0.3	-0.3	-2.9	
Bank and Naftogaz recapitalization	1.1	3.8	5.7	5.2	0.0	0.0	0.0	0.0	0.0	5.2	
Other adjustments	0.0	0.0	0.0	0.0	0.1	0.0	-0.1	0.1	0.2	0.2	
Residual, including asset changes [8/]	1.7	-1.0	0.9	9.2	1.7	-1.7	-1.8	-1.9	-1.9	3.6	



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 1.3 percent of GDP in 2016, 0.6 percent in 2017, and 0.3 percent in 2018-2021.

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 - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) 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 - π (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).

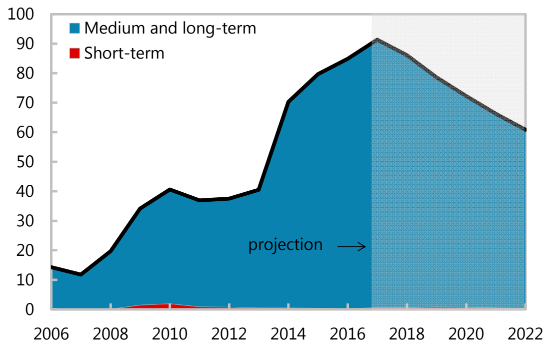
8/ Includes changes in the stock of guarantees (including IMF financing to NBU), and asset changes. For projections, includes exchange rate changes during the projection period.

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.

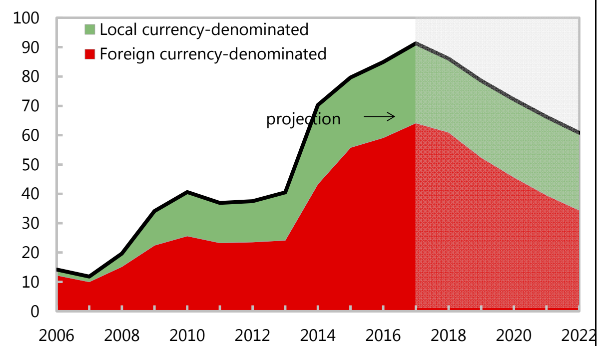
Annex III. Figure 4. Ukraine: Public DSA—Composition of Public Debt and Alternate Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



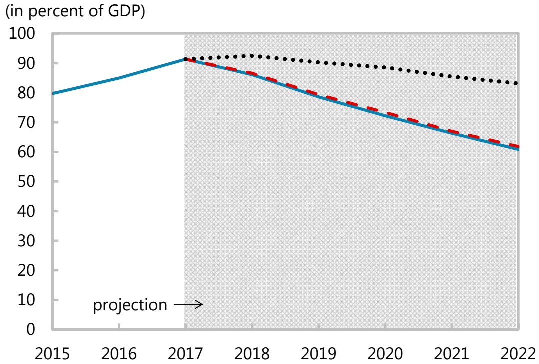
By Currency
(in percent of GDP)



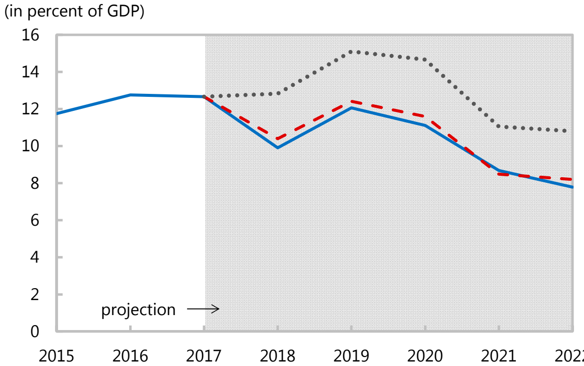
Alternative Scenarios

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)

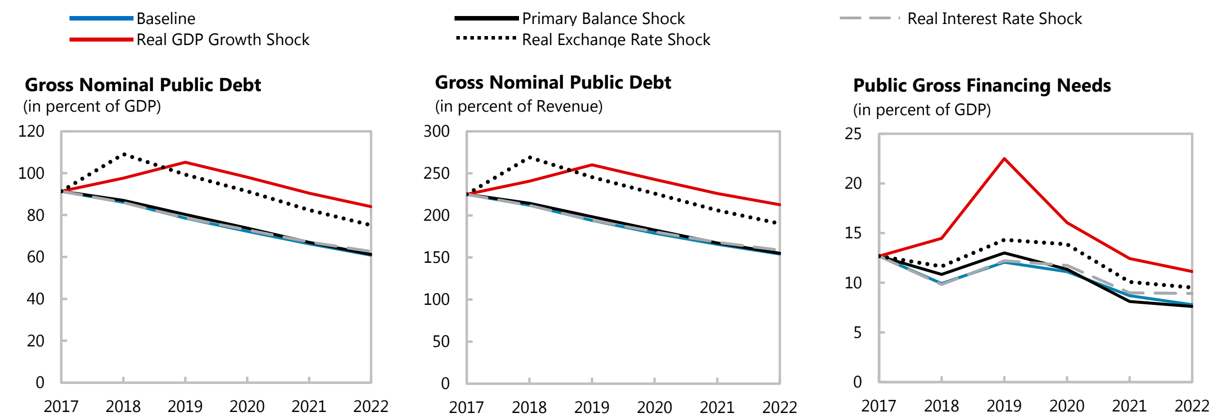
Baseline Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	2.9	3.1	3.5	4.0	4.0	4.0
Inflation	12.0	9.0	7.5	6.0	6.0	6.0
Primary Balance	1.2	1.8	1.8	1.8	1.8	1.8
Effective interest rate	6.9	6.7	6.8	7.1	7.4	7.8
Constant Primary Balance Scenario						
Real GDP growth	2.9	3.1	3.5	4.0	4.0	4.0
Inflation	12.0	9.0	7.5	6.0	6.0	6.0
Primary Balance	1.2	1.2	1.2	1.2	1.2	1.2
Effective interest rate	6.9	6.6	6.4	6.8	7.1	7.3

Historical Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	2.9	-1.3	-1.3	-1.3	-1.3	-1.3
Inflation	12.0	9.0	7.5	6.0	6.0	6.0
Primary Balance	1.2	-0.7	-0.7	-0.7	-0.7	-0.7
Effective interest rate	6.9	6.6	5.3	4.5	3.9	3.6

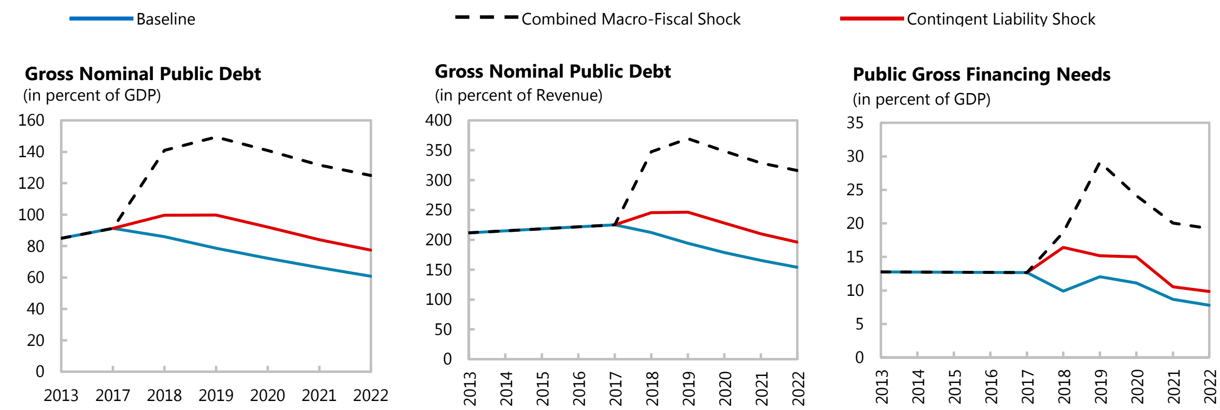
Source: IMF staff.

Annex III. Figure 5. Ukraine: Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

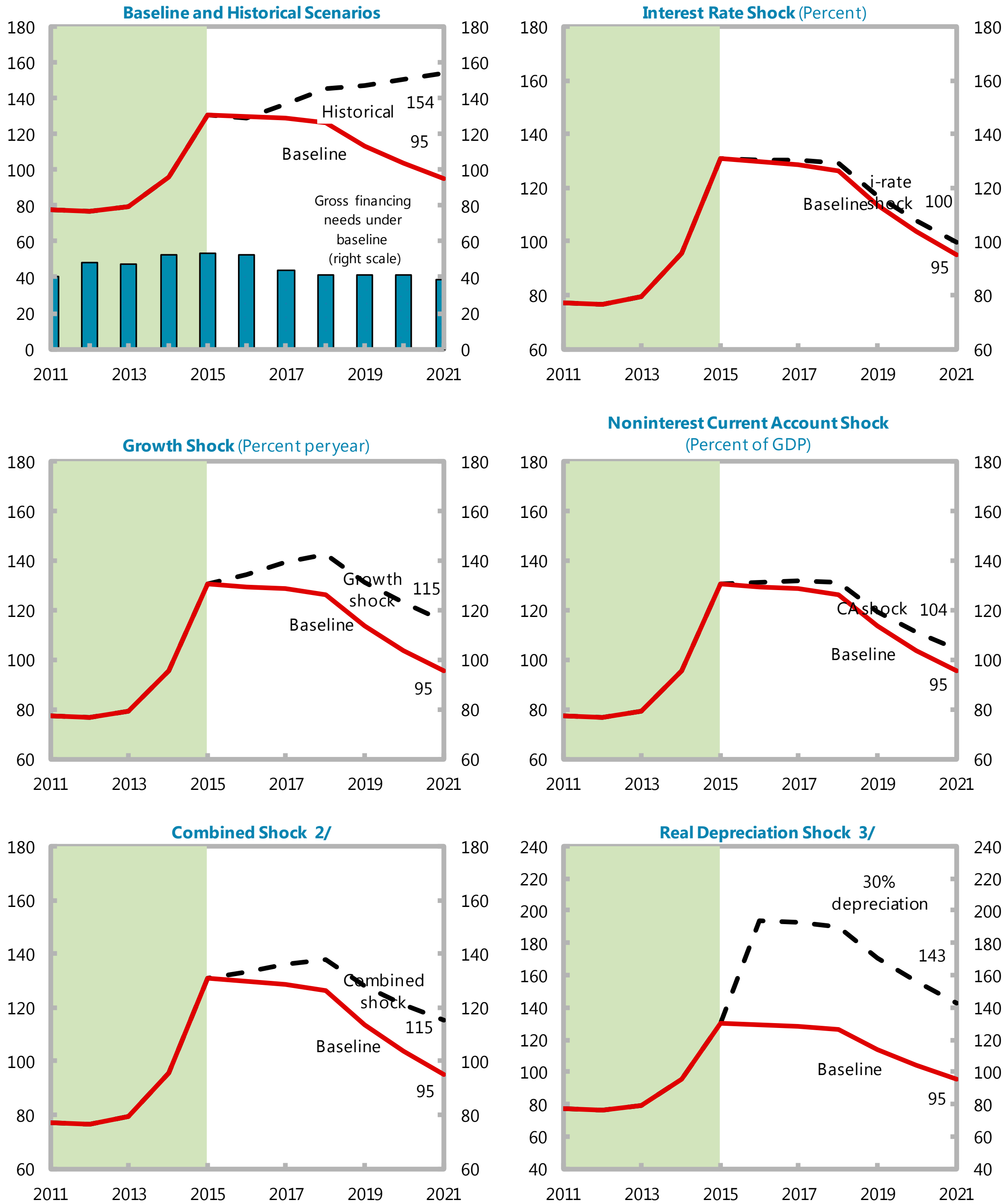
Primary Balance Shock	2017	2018	2019	2020	2021	2022
Real GDP growth	2.9	3.1	3.5	4.0	4.0	4.0
Inflation	12.0	9.0	7.5	6.0	6.0	6.0
Primary balance	1.2	0.8	0.8	1.8	1.8	1.8
Effective interest rate	6.9	6.6	6.5	6.9	7.1	7.4
Real Interest Rate Shock						
Real GDP growth	2.9	3.1	3.5	4.0	4.0	4.0
Inflation	12.0	9.0	7.5	6.0	6.0	6.0
Primary balance	1.2	1.8	1.8	1.8	1.8	1.8
Effective interest rate	6.9	6.6	7.1	8.3	9.1	9.8
Combined Shock						
Real GDP growth	2.9	-4.0	-3.6	4.0	4.0	4.0
Inflation	12.0	7.3	5.8	6.0	6.0	6.0
Primary balance	1.2	-1.7	-5.7	1.8	1.8	1.8
Effective interest rate	6.9	8.1	5.9	7.6	8.6	9.4

Real GDP Growth Shock	2017	2018	2019	2020	2021	2022
Real GDP growth	2.9	-4.0	-3.6	4.0	4.0	4.0
Inflation	12.0	7.3	5.8	6.0	6.0	6.0
Primary balance	1.2	-1.7	-5.7	1.8	1.8	1.8
Effective interest rate	6.9	6.6	6.6	7.6	7.8	7.9
Real Exchange Rate Shock						
Real GDP growth	2.9	3.1	3.5	4.0	4.0	4.0
Inflation	12.0	25.3	7.5	6.0	6.0	6.0
Primary balance	1.2	1.8	1.8	1.8	1.8	1.8
Effective interest rate	6.9	8.1	5.8	6.3	6.6	7.0
Contingent Liability Shock						
Real GDP growth	2.9	-4.0	-3.6	4.0	4.0	4.0
Inflation	12.0	7.3	5.8	6.0	6.0	6.0
Primary balance	1.2	-3.4	1.8	1.8	1.8	1.8
Effective interest rate	6.9	7.0	6.5	6.8	7.0	7.3

Source: IMF staff.

Annex III. Figure 6. 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 2016.

Annex III. Table 1. Ukraine: Program External Debt Sustainability Framework, 2013–21

(Percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing non-interest current account 6/
	2013	2014	2015			2016	2017	2018	2019	2020	2021	
Baseline: external debt	79.1	95.4	130.6			129.4	128.5	126.3	113.5	103.8	95.3	-6.2
Change in external debt	2.5	16.3	35.1			-1.1	-0.9	-2.2	-12.8	-9.7	-8.5	
Identified external debt-creating flows (4+8+9)	4.6	32.2	40.8			-2.7	-2.2	-3.6	-4.6	-5.1	-4.3	
Current account deficit, excluding interest payments	3.2	-1.5	-5.8			-2.0	-3.7	-4.4	-4.1	-3.7	-3.0	
Deficit in balance of goods and services	8.7	3.9	1.9			6.3	4.0	3.8	3.8	4.0	4.2	
Exports	45.5	49.4	52.8			51.5	52.4	51.9	50.5	49.7	48.4	
Imports	54.2	53.3	54.7			57.7	56.4	55.7	54.4	53.8	52.6	
Net non-debt creating capital inflows (negative)	-2.9	0.1	-3.5			-3.8	-1.7	-2.5	-3.2	-3.6	-3.4	
Automatic debt dynamics 1/	4.4	33.6	50.2			3.1	3.2	3.3	2.8	2.2	2.0	
Contribution from nominal interest rate	6.0	5.3	6.1			5.8	6.7	7.0	6.8	6.3	5.8	
Contribution from real GDP growth	0.0	7.0	13.8			-2.6	-3.5	-3.8	-4.0	-4.1	-3.8	
Contribution from price and exchange rate changes 2/	-1.7	21.2	30.3			...	...	...	...	...	...	
Residual, including change in gross foreign assets (2-3) 3/	-2.1	-15.8	24.6			1.5	1.3	1.4	-8.3	-4.6	-4.2	
External debt-to-exports ratio (percent)	173.9	193.0	247.3			251.5	245.4	243.3	224.6	208.7	196.7	
Gross external financing need (billions of U.S. dollars) 4/	85.5	69.9	48.1			46.9	41.5	41.9	46.8	51.0	52.2	
Percent of GDP	47.6	52.8	53.1			52.6	43.6	41.0	41.4	41.3	38.7	
Scenario with key variables at their historical averages 5/				10-Year Historical Average	10-Year Standard Deviation	129.1	136.4	145.0	146.8	150.3	153.9	3.1
Key macroeconomic assumptions underlying baseline												
Real GDP growth (percent)	0.0	-6.6	-9.9	-0.8	7.6	2.0	2.9	3.1	3.5	4.0	4.0	
GDP deflator in U.S. dollars (change in percent)	2.2	-21.1	-24.1	2.9	19.0	-3.3	3.7	4.2	6.7	5.2	5.1	
Nominal external interest rate (percent)	8.0	5.0	4.3	7.1	1.4	4.3	5.5	5.9	6.0	6.1	6.2	
Growth of exports of goods and services (U.S. dollar terms, percent)	-9.2	-19.9	-27.0	3.9	25.9	-3.9	8.5	6.5	7.6	7.6	6.5	
Growth of imports of goods and services (U.S. dollar terms, percent)	-6.7	-27.5	-29.9	5.9	31.0	4.1	4.2	6.2	7.8	8.2	7.0	
Current account balance, excluding interest payments	-3.2	1.5	5.8	0.6	3.1	2.0	3.7	4.4	4.1	3.7	3.0	
Net non-debt creating capital inflows	2.9	-0.1	3.5	4.4	2.2	3.8	1.7	2.5	3.2	3.6	3.4	

1/ 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 of domestic-currency denominated debt in total external debt.

2/ 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).

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

4/ 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.

5/ 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.

6/ 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.

Annex IV. Risk Assessment Matrix[1]

Source of Risk and Relative Likelihood	Expected Impact and Recommended Policy Response
Domestic Risks	**Domestic Risks**
Medium Domestic political instability, including possible early elections, policy reversals, and slow program implementation	*Medium* Political instability would undermine economic activity by creating economic uncertainty and eroding investor and consumer confidence. Furthermore, the government's inability to undertake pressing economic policy reforms will also negatively impact investment and growth. The authorities should take steps to build political consensus by prioritizing those measures that will deliver growth and investment. Increased transparency and the fight against corruption will also build trust in the authorities' intentions and garner support from the population, allowing to build stronger coalitions. Strong policy ownership will ensure proper and timely implementation.
Medium Pressures to increase wages and pensions to socially more acceptable levels	*Medium* This could significantly undermine macro and debt sustainability, which is built on primary fiscal surpluses of about 2 percent of GDP in the medium term. The authorities should advance with public administration and pension reforms to right size the public sector and align the retirement age with other countries to make fiscal space for higher wages and pensions.
Medium Increased trade tensions with Russia (or higher-than-expected impact of the 2016 transit ban)	*Medium* New trade restrictions imposed in early 2016 included the cancellation of the free trade agreement with Russia, a ban on agro-food exports from Ukraine as well as transit restrictions for products destined to Kazakhstan. The impact will depend on the ability to adopt to a new export route, higher exports to Europe as a result of DCFTA with the European Union.
Low A more protracted and volatile bank resolution process	*Medium* A protracted bank resolution process could erode depositors' confidence in the banking system, putting a strain on banks' liquidity and potentially leading to bank runs. Moreover, as banks repair their balance sheets, the credit channel will be impaired, leading to lower credit availability and lower investment and growth. The authorities should ensure that banks make steady progress in their recapitalization and restructuring efforts, including unwinding related-party exposures, encouraging banks to recover loans and improve quality of loan collateral, and addressing the high stock of NPLs. In parallel, the authorities need to further strengthen their crisis preparedness plans, as formulated by the set of principles that would guide a possible resolution of systemic banks.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. (The scenario most likely to materialize in the view of IMF staff.) The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("Low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent.) The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Source of Risk and Relative Likelihood	Expected Impact and Recommended Policy Response
Domestic Risks	**Domestic Risks**
Low An intensification of the conflict in the Eastern part of Ukraine	*High* A substantial intensification of the conflict could quickly and sharply erode confidence, putting significant strain on banks' liquidity and the exchange rate. Production, trade, and investment could be severely impacted, causing a sharp decline in GDP and incomes. The authorities would need to tighten fiscal and monetary policies, as well as impose exchange restrictions and limits on deposit withdrawals to try and stem outflows.
External Risks	**External Risks**
Medium/High Tighter and more volatile global financial conditions, including from an unanticipated Fed rate hike	*Low* The rise in risk premia and flight to safety associated with the tighter and more volatile global conditions is not likely to have an effect on Ukraine in the near term given the ongoing lack of market access and capital controls. However, Ukraine will need to return to capital markets by end-2017 to close its financing gap.
Low/Medium A significant slowdown in China and other major emerging markets and structurally weak growth in the euro area and key advanced and emerging economies	*Medium* Weaker domestic demand in China that suppresses commodity prices would have an impact on Ukrainian exports of ferrous metals. A slowdown in other major EMs would also adversely affect trade via lower exports. While there is a shift of export markets towards Europe, a permanently slow growth in the euro area would hamper this ongoing export market redirection away from CIS. Structural reforms such as deregulation and state-owned enterprise reform should unlock additional growth potential.
Medium (Significant) negative terms of trade shock from lower commodity prices	*High* A negative terms of trade shock, such as the one observed in 2015, where both steel and agricultural product export prices declined substantially would have a high negative impact on exports, growth and reserve accumulation. Export product diversification would help with decreasing the dependency on highly volatile commodity prices.

Ukraine: Letter of Intent

Kyiv, March 2, 2017

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

Dear Ms. Lagarde:

1. We reaffirm our commitment to the policies and objectives of the economic program supported by an IMF arrangement under the Extended Fund Facility (EFF). In the attached supplement to the Memoranda of Economic and Financial Policies (MEFP) from February 27 and July 21, 2015, and September 1, 2016, we outline further policy steps toward meeting these objectives.

2. We have successfully moved the economy out of the deep recession. The economy is now recovering, inflation has declined to close to single digits, official reserves have more than doubled, and the financial system is getting stronger. This reflects our steadfast efforts to implement the policies and reforms under our EFF-supported program. Nonetheless, the economy continues to face significant challenges, including low growth that does not benefit all, a still high level of public debt, and a weak business climate, including from persistent corruption and an inefficient and large state sector. Remaining weaknesses in the financial sector still prevent it from playing its role in supporting growth. The challenge ahead is to continue to maintain fiscal and external stability, reduce financial vulnerabilities, and most importantly move ahead with the long-delayed structural transformation of the economy to achieve durable, strong and inclusive growth to catch up with our regional peers.

3. Our actions ensured that we met all continuous and end-December 2016 quantitative performance criteria (PCs) and indicative targets (ITs), except for the IT on VAT refund arrears (Table 1). We, however, met only 3 out of 11 structural benchmarks set for the period from September through December 2016 (Table 2), as our focus has been on key measures to ensure fiscal sustainability and financial stability.

4. Most notably, since the completion of the second review, our efforts have been directed at the following (all prior actions for the completion of this review (see also Table 2):

- *Fiscal policy*. Parliament has adopted a 2017 budget in line with the program deficit target of 3.1 percent of GDP. To ensure that the deficit target is achieved, we have taken a number of steps, including adopting legislation to limit fiscal risks from the increase in the minimum wage; putting in place an automatic adjustment mechanism for gas and heating tariffs to ensure that tariffs remain at market levels; and adjusting the parameters of the utility-related social assistance programs to ensure their better targeting and efficiency.

- *Financial stability*. Out of the 39 largest banks, most have strengthened their capital position as required under our bank recapitalization program. We have resolved those that were unable to meet minimum capital requirements, including by nationalizing the largest and systemic privately owned bank.

- *Fighting corruption*. For the first time in Ukraine's history, we have published the asset declarations of high-level officials, sending an important signal about our determination to improve transparency. High-level officials that failed to report have been referred to the National Anti-Corruption Bureau of Ukraine (NABU).

5. Against this background, we request to reset—and in a few instances also modify—the remaining eight structural benchmarks as outlined in the attached MEFP and propose a number of new benchmarks to help maintain the reform momentum (see Table 2). Notably, we request that the benchmarks on pension reform and land reform be reset to end-April and end-May 2017, respectively, to provide more time to build social consensus for these critical reforms.

6. On the basis of steps that we have already taken and our commitments for the period ahead, we request completion of the third review, and a disbursement in the amount of SDR 734.05 million based on the end-December 2016 performance criteria. Given the delay in completing this review, we request the fourth review under the arrangement to be based on the end-March 2017 performance criteria, and that the remaining amounts be allocated over the next seven purchases, as set out in Table 3. Furthermore, we also request the completion of the financing assurances review.

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 in advance with the IMF on the adoption of these measures or on any 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 program monitoring. Reaffirming our commitment to transparency, we

consent to the IMF's publication of this letter, the MEFP, the Technical Memorandum of Understanding, and the accompanying Executive Board documents immediately upon completion of the review by the IMF's Executive Board.

Yours sincerely,

/s/ Petro Poroshenko President	/s/ Volodymyr Groysman Prime Minister
/s/ Oleksandr Danylyuk Minister of Finance	/s/ Valeria Gontareva Governor, National Bank of Ukraine

Attachment I. Ukraine: Memorandum of Economic and Financial Policies

1. **Our policies remain focused on reducing vulnerabilities, accelerating growth and creating private sector jobs, while strengthening macroeconomic stability**. We are committed to preserving the achievements to date and to continue implementing in full the measures agreed since the start of the program. Our policies are centered on: (i) maintaining a cautious monetary policy geared toward further reducing inflation and rebuilding reserves, while repairing viable banks and reviving bank lending; (ii) continuing fiscal consolidation to ensure medium-term debt sustainability, supported by pension reform and making the tax system more efficient and growth friendly, while improving the quality of government spending; and (iii) accelerating structural reforms to reform the large state-owned enterprise (SOE) sector, improve the business environment and tackle corruption, to attract investment and raise the economy's potential.

A. Monetary and Exchange Rate Policies

2. **We are fully committed to an institutionally strong and independent National Bank of Ukraine (NBU) that can effectively focus on meeting its objectives of price and financial stability**. We will ensure that this framework remains unchanged going forward.

3. **Monetary policy will continue to be aimed at reducing inflation to achieve the targets under the NBU's inflation targeting framework**. The Monetary Policy Guidelines for 2017 and Medium Term were approved by the NBU Council in December 2016, setting inflation targets of 8, 6 and 5 percent for 2017, 2018 and 2019, respectively. These guidelines also define the main principles of our monetary policy, to which the NBU will firmly adhere, including the priority of achieving price stability, maintaining a flexible exchange rate, maintaining NBU independence, and assuring transparency of NBU activities. Within this framework, the NBU will aim to accumulate international reserves in line with our program with the IMF, while gradually relaxing foreign exchange restrictions (see below). The NBU will continue to strengthen its inflation targeting framework, with technical assistance from the IMF, including by enhancing liquidity forecasting and moving toward more active liquidity management to help develop the interbank market, as well as by further enhancing its communication, accountability framework, and macroeconomic modeling. Meeting the inflation targets will help improve policy credibility, lengthen investment horizons, decrease dollarization, and strengthen monetary transmission.

4. **The monetary policy stance will remain appropriately tight to achieve these objectives**. Given the still elevated inflation expectations and risks to the outlook, we will ease our monetary

policy stance gradually as inflation and risks abate and reserve targets are met, maintaining the key policy rate appropriately positive in real terms. In the event of unexpected shocks that endanger the achievement of our inflation targets, we will use the key policy rate and other tools to bring inflation to our target within a reasonable forecast horizon.

5. **Our recently announced foreign exchange intervention strategy reflects our commitment to increasing transparency and deepen liquidity in the foreign exchange market**. Our strategy remains fully consistent with the objectives of continuing to strengthen our reserve position within a framework where the exchange rate is fully driven by fundamentals. In this regard, we aim to develop a liquid foreign exchange market that will be better able to absorb shocks. With technical assistance from the IMF, the NBU will elaborate the institutional and operational reforms needed to further develop the foreign exchange market and increase its resiliency, while remaining foreign exchange restrictions are gradually being removed.

6. **We will continue to ease foreign exchange restrictions and administrative controls as conditions allow**. We have agreed with the IMF a revised conditions-based roadmap, taking into account the results of previous relaxations, updated impact assessments and additional stages on the road toward the complete removal of the measures. The roadmap prioritizes easing the more distortive current account restrictions and reducing disincentives for foreign direct investment, conditional on meeting our reserve targets, as well as ensuring macro-financial stability and enhanced information collection and enforcement powers. The NBU will monitor the impact of relaxation measures, update assessments as new information becomes available and adjust the easing steps as needed, in order to ensure that the gradual removal of restrictions remains consistent with the conditions specified above.

7. **We have continued to strengthen the governance and operational structures of the NBU**. We appointed a new audit committee, with strong professional qualifications to improve the oversight of internal controls. The NBU has also reformed its emergency liquidity assistance (ELA) framework, adopting international best practices. The new ELA framework, which will replace stabilization loans, places emphasis on preparatory work (e.g., pre-evaluation of collateral) that will make it possible to respond quickly when needed, while also having terms and conditions to minimize moral hazard and safeguard the NBU balance sheet.

B. Financial Sector Policies

8. **We have taken major steps to ensure a well-functioning and sound financial system**. Most of the largest 20 banks (group I) in the country, accounting for 88 percent of banking system

assets have been making good progress toward meeting regulatory capital norms in line with the agreed recapitalization plans. Those banks in group I that were unable, according to the 2015 NBU diagnostics, to meet a minimum capital adequacy ratio (CAR) of at least 5 percent, as well as banks in the next group of 19 largest banks (group II) that were unable to reach at least zero capital have been resolved (a ***prior action*** for this review), and of which PrivatBank was nationalized given its systemic importance. With this, as of mid-January 2017, 88 banks, accounting for almost 50 percent of banking system assets at the beginning of 2014, have been resolved as part of our continuous commitment to strengthen and consolidate the financial system. In addition:

a. In the case of the recently nationalized PrivatBank, we are taking decisive steps to ensure that its nationalization is efficient and transparent and minimizes costs to the State:

    i. We have appointed a new supervisory and management board. The supervisory board is comprised of seven members that meet the criteria stipulated in paragraph 27b and c of the Principles of State Banking Sector Strategic Reforms.

    ii. To address the bank's immediate capital needs—arising from loan losses of UAH 155 billion and adjusted by the bail-in of creditors for UAH 29 billion—the Ministry of Finance (MoF) has recapitalized the bank through government bonds in the amount of UAH 117 billion, issued at market-based rates. In case of liquidity needs, the NBU stands ready to purchase a portion of these instruments or provide refinancing loans secured by the above-mentioned recapitalization bonds, while ensuring consistency with the NBU's monetary program. The currently outstanding NBU liquidity facilities will not be restructured in a way that the effectiveness of the former bank owners' personal guarantees associated with such facilities is undermined.

    iii. To remove uncertainty and strengthen depositors' confidence during the nationalization phase, we have passed legislation to temporarily protect PrivatBank's household deposits in full. In the context of the Principles of State Banking Sector Strategic Reforms, we intend to gradually remove the government guarantee on deposits held in state-owned banks (SOBs).

    iv. The bank's new supervisory board has already: (a) selected an internationally recognized audit firm to perform a due diligence of the bank's balance sheet at its intervention date, as required by the Deposit Guarantee Fund (DGF) law, to define the nationalized bank's capital needs according to fair value practices; and (b) approved the establishment of a specialized unit inside the bank to manage and restructure loans and financial leasing agreements of about UAH 155 billion identified by the NBU to be related to the former bank owners on the basis of the current legal and regulatory framework, as well as other impaired loans. Before end-March 2017, the bank's General Meeting of Shareholders will approve the terms of reference—developed in consultation with IMF staff—for, and launch the process for hiring of, an internationally recognized firm (IRF) with the appropriate expertise that, on behalf of the bank, will negotiate the restructuring and collection terms of the loans above mentioned, as well as of other impaired loans, which requires the use of similar approach, on the basis of international best practices, including as a minimum borrowers' and lessees' reliable and credible supporting information on ultimate beneficiary owners, financials, main activities, and proper collateral valuation. Furthermore, we will ensure that the bank's supervisory board by end-April 2017 selects the IRF on the basis of a transparent process, and selects a reputable international audit firm to conduct for the next two years a semi-annual detailed independent loan review (in accordance with the legal and NBU regulatory framework), with the aim of properly monitoring asset value recovery (a new ***structural benchmark)***. These interim reports, prepared by the audit firm will be completed by end-September 2017, end-March 2018, end-September 2018, and end-March 2019, respectively.

v. The supervisory board is expected to approve by mid-May 2017 the IRF's strategy to restructure the above-mentioned loans through end-June 2017, which will reflect best practices—a brief summary of this strategy and bi-monthly implementation progress reports will be made public in a timely manner, and consistent with applicable banking secrecy and data protection requirement, at the bank's website.

vi. By end-May 2017, in consultation with IMF staff, on the basis of the above mentioned due diligence and the bank's business plan (prepared by its newly appointed supervisory and management board)—which is to include restructuring and strategic measures (including as regards to lending activities through end-2018)—we will decide on final steps to complete the bank's restructuring, including the coverage of any additional capital needs assessed at that time. The MoF (through its FPD) and the NBU will require the bank to submit bi-monthly progress reports on the implementation of its business plan to ensure effective official monitoring.

vii. By end-June 2017, the IRF, in close coordination with the bank's supervisory board, will seek to complete the restructuring and collateral enhancement or collection of PrivatBank's impaired loans, including those to parties related to its former owners, in line with the principles established in the strategy above, such that the losses associated with these loans that were accounted by the DGF at the time of the bank's intervention are reversed.

viii. We remain fully committed to follow international best practices and the banking law to pursue all legal and commercial means available to recover the loans mentioned above in a timely manner. In this context, by mid-March 2017, the NBU will extend and expand the work of the internationally recognized firms that have been assisting the NBU in this case. This includes expanding the mandate of the internationally recognized firm that had been assisting the NBU in identifying related-party transactions to perform a forensic audit of PrivatBank's operations to identify whether wrongdoing or bad banking practices took place prior to the bank's nationalization, with the aim to complete this audit by mid-September 2017.

b. To ensure sufficient time for the verification of group II and III banks' recapitalization and unwinding measures, we have slightly revised the timetable for their compliance as shown in the table below.

Calendar of next 100 banks	**Completion of**		**Recapitalization to**	
	Diagnostics	Board Approval	Zero Tier 1	CAR of 5 percent
Group II (largest 19)	End-May 2016	End-July 2016	Mid-January 2017	End-April 2017
Group III (next 21)	End-September 2016	End-December 2016	End-March 2017	End-June 2017
Remaining banks	Continuous process to be completed by no later than End-September 2017			

c. From the banks of groups I and II showing negative operating profitability through 2017, we have requested the submission of restructuring plans (including quarterly targets) by end-April 2017, with measures to be adopted in the next 36 months to reverse such trend and ensure their viability. By end-June 2017, the NBU, in consultation with the IMF and World Bank staff, will review these plans and approve when adequate. Furthermore, banks from group III showing such patterns through 2018 must submit their restructuring plans by end-May 2017 and the NBU shall complete their review by end-July 2017.

d. In addition, we have started focusing on strengthening all remaining banks in the banking system. The completion of the diagnostics of the remaining banks (accounting for less than 2 percent of the system assets) will be completed by end-September 2017, on the basis of terms of reference already agreed with IMF and World Bank staff. Where applicable, the remaining banks will submit their restructuring plans on a continuous process to be reviewed and approved by the NBU no later than end-December 2017. Furthermore, as envisaged in the current legislation, we will ensure that by mid-July 2017 all banks hold at least a minimum capital of UAH 200 million. Banks that fail to meet this requirement will be resolved.

9. We will ensure that all banks strictly adhere to targets set for the unwinding and limitation of their exposure to related parties. To this end, the Related Party Monitoring Office (RPMO), in addition to overseeing banks' full adherence to their unwinding plans in strict compliance with the terms of reference agreed with IMF staff, by end-March 2017, will complete a work plan for the following 12 months on the basis of a revised set of objectives, modes of coordination with other relevant NBU departments, and monitoring procedures, agreed with a recent IMF TA mission. Furthermore, we remain committed to keep the RMPO as the undisputed center of expertise on related-party issues, as envisaged at its creation.

10. We are working toward establishing a credit registry in NBU. To this end:

a. By end-March 2017, we will seek parliamentary approval of legislation to authorize the NBU to establish a credit registry with a view to start collecting information from banks by end-September 2017 and by end-December 2018 commence sharing this information with the banking industry (disclosing borrowers' exposures loan by loan, but without indicating what individual institution is the creditor), with the view to enhance its lending practices, according to a minimum threshold defined by the NBU in line with international best practices (including credit risk assessment). Furthermore, considering that nearly 80 banks are under liquidation, the legislation will also introduce requirements on these institutions to regularly report to the NBU their credit data and allowing the NBU to share such information with private credit risk bureaus.

b. Within two months of the adoption of the above-mentioned law, the NBU will issue the corresponding regulations and action plan to ensure timely implementation.

c. By end-April 2017, in consultation with Fund staff, we will define proper procedures to share NBU information on the composition of related economic groups with the industry, to enable banks to effectively enhance the monitoring of their credit concentration limits.

11. We continue enhancing our supervision and regulation of banks. By end-March 2017, with input from the IMF and World Bank staff, the NBU will complete the identification of remaining key policy measures that are required to ensure our compliance with the Basel Core Principles (BCPs) as per our peer group, on which basis we will prepare an action plan through end-2019, to be approved by the NBU Board by end-April 2017. Furthermore, on the basis of its assessment of the banks' pro-forma balance sheet, the NBU will has amended its new regulation on credit risk to make it technically better calibrated with best practices. The potential impact of these changes will be communicated to each individual institution that has additional capital needs arising from the adoption of the new regulations, requiring them to reflect this in the remaining horizon of their recapitalization plans. Additionally, the NBU will:

a. By end-April 2017, prepare an interim report board on progress made toward adopting risk-based supervision by end-June 2017; and

b. By end-May 2017, with technical external assistance, benchmark its revised supervisory structure, internal procedures (including coordination between offsite supervision and onsite inspection) and administrative arrangements (including staff count and budgets) against those of peer countries.

12. We will take steps to ensure effective corporate governance in banks. We have completed the initial assessment of our current regulatory and supervisory framework for sound risk governance practices against the 2015 Basel's Guidelines for Corporate Governance for banks. Additionally, we have issued prudential regulations towards enhancing governance at banks, including guidelines on the functioning of internal audit functions. Going forward:

a. By end-March 2017, the NBU will submit draft legislation to parliament to address legal loopholes arising from the assessment above mentioned. We expect parliament to adopt this legislation by end-June 2017. The NBU will adopt revised or new resolutions reflecting the findings of the assessment for full implementation no later than end-December 2017; and

b. The NBU, with external support, will: (i) by end-September 2017 approve a regulation on minimum organizational and functioning conditions for an effective risk management system at banks; and (ii) by end-April 2018 complete its assessment of the collective suitability of the board and qualifications of senior management of the 10 largest banks and, where applicable, instruct banks to adopt corrective measures within 90 days. By end-July 2018, a similar assessment for the next 10 largest banks will be completed. The remaining banks will be subject to the same review through end-April 2019 in line with a calendar to be agreed with IMF staff by end-September 2017.

13. We continue implementing our strategy for the public banks. The strategy includes the Principles of State Banking Sector Strategic Reforms to govern the SOBs, approved by the Cabinet of Ministers of Ukraine (CMU) in early February 2016. The MoF, in consultation with IMF staff, will prepare amendments to the strategy in light of the nationalization of PrivatBank, to be approved by the CMU by end-April 2017. Based on this strategy:

a. The CMU will assume the role of controlling shareholder of the SOBs, supported by the MoF's FPD.

b. In consultation with IMF staff, in March 2017 we will submit to parliament the draft law on SOBs that facilitates the adoption of the new corporate governance approach and expect this law to be adopted by end-March 2017.

c. By end-March 2017, with IMF technical assistance, we will complete a new organizational structure of the FPD and an action plan for its strengthening through end-June 2017, for it to be able to effectively support the CMU's function of managing the State's interest in the SOBs.

d. By end-June 2017, the MoF's Financial Policy Department (FPD), in consultation with IMF staff, will establish Memoranda of Understanding with all SOBs (PrivatBank, Oschadbank, Ukreximbank, Ukrgasbank) in order to *inter alia* define a relationship framework between the MoF and each bank, and safeguard each bank's commercial independence in achieving its objectives.

e. The supervisory board of each of the SOBs will be selected in line with the Principles of State Banking Sector Strategic Reforms, which *inter alia* requires the candidates to be proposed by a reputable international recruitment firm. However, if the SOBs were to receive private participation, the selection process of the independent members of the SOB's supervisory boards will be made on the basis of the Law on State-Owned Enterprises.

f. We will refrain from making operational the recently created Export Credit Agency until all related cost and capital needs for the next three years are clearly identified, on the basis of an independent assessment, and included in the government budget.

14. The DGF is working to further enhance its transparency, recovery procedures, and asset disposal procedures. A centralized unit at the DGF is now set to consolidate the management and control of bank assets from the nearly 80 resolved institutions. We fully commit to:

a. We will submit legislation to parliament that will further enhance the DGF's ability to work with assets in a timely and efficient manner and increase the amount of net cash recoveries on assets, as well as providing legal protection to DGF staff. We expect this law to be adopted by end-March 2017.

b. The first executive summary of the forensic audits was published and the second will be published by mid-March 2017. By mid-March 2017, the DGF also will launch the selection process for the next three forensic audit exercises.

c. The disposal of assets through international platforms of distressed assets, aiming to dispose of at least UAH 10 billion worth of assets by end-June 2017.

d. By end-September 2017, the DGF will publish its review of a selected pool of assets sold in the preceding two years. To this end, by end-March 2017, the DGF will agree with IMF and World Bank staff the terms of reference for its regular examinations of asset sales, including their scope and frequency.

15. We will further strengthen our regime for corporate debt restructuring and protection of creditors' rights. Parliament already adopted amendments to the Law on Enforcement Procedures to speed up the enforcement process. By end-September 2017, parliament is expected to adopt the amendments to the Law on Restoration of Debtor's Solvency or Declaration of its Bankruptcy (draft bill No. 3132(d)), to facilitate restructuring procedures and increase the efficiency of liquidation (a new deadline for this ***structural benchmark,*** reset from end-September 2016). Parliament will also adopt by end-September 2017 legislation to strengthen the provisions in the Code of Civil Procedure and the Code on Commercial Procedure and related laws on the automated collection and enforcement of debts Orders for Payments for domestic transactions and Garnishment of Bank accounts (a new deadline for this ***structural benchmark***, reset from end-September 2016). Furthermore, recognizing the need to eliminate tax disincentives to restructuring, by end-June 2017 the MoF, in consultation with the NBU, will submit legislative changes to the tax code to change the definition of "bad debts" to allow for the write-off of uncollectable debts without having to initiate or complete a bankruptcy process (e.g., 360 days post default) and to extend the tax incentives available on a temporary basis to out-of-court restructurings under the Law on Financial Restructuring to debt restructurings subject to the insolvency law. Additionally, regarding the possible restructuring of mortgage loans denominated in foreign currency, in line with our commitment made in earlier Memorandum of Economic and Financial Policies (MEFP), we will support only legislative initiatives that are consistent with the existing agreement reached between the NBU and the banking industry.

16. We are committed to establishing a strong regulatory framework for securities markets and non-bank financial institutions, as well as banks. To this effect:

a. We are reinforcing the powers, independence and institutional capacity of the National Securities and Stock Market Commission (NSSMC), aiming *inter alia* at allowing it to become a signatory to IOSCO's Multilateral Memorandum of Understanding. To achieve this, we will seek parliamentary approval by end-April 2017 of legislation that meets the objectives outlined in points a through j of paragraph 22 of the MEFP dated September 1, 2016.

b. With the assistance of international donors, the NSSMC is reforming its internal organization and procedures. In particular, a functional structure is being introduced to replace the sectoral one. A further redesign of key processes including governance mechanisms, decision-making procedures, responsibilities, internal controls and operational risk prevention systems will be developed and implemented during the next 18 months. To this end, by end-April 2017 we will agree with IMF staff an action plan with clear quarterly targets.

c. Supervisory responsibilities for a variety of financial intermediaries will be reassigned from the National Commission of Financial Services (NCFS) to the NBU and the NSSMC. In particular, the NBU will become responsible for the regulation and supervision of insurance and leasing companies, credit unions, credit bureaus and other non-bank lenders, pawnshops and other financial companies and the NSSMC for private pension funds, issuers of mortgage certificates, funds for construction financing and real estate funds. The relevant legislation was adopted by parliament in first reading in July 2016. We are working to ensure that this legislation is adopted in second reading by end-March 2017 and fully implemented by end-December 2017.

d. To improve the functioning of financial markets, enhance transparency and the quality of issuer disclosures, and to reduce the scope for corruption and fraud, we will adopt a new Audit Law and a revised Accounting Law based on EU standards. These laws, which have been developed with assistance from the EU and the World Bank, will bring Ukraine's accounting framework broadly in line with the EU Accounting Directive and establish a new oversight structure for the audit profession, while safeguarding the NBU's and NSSMC's ability to set additional standards for auditors of banks and other regulated entities (professional market participants and issuers) in a transparent manner. These laws will be adopted by end-July 2017.

C. Income Policies

17. To reduce extensive labor informality and support vulnerable households, we have increased the minimum wage to UAH 3,200, effective January 1, 2017. While we believe this was a necessary step, we recognize that it also poses risks to our macroeconomic achievements to date, including fiscal sustainability and competitiveness, if this is followed by generalized and significant wage increases in the economy beyond productivity improvements. To limit these risks, parliament adopted legislation to delink the minimum wage from a range of wage setting and administrative decisions, as described below, to ensure that the impact on the budget deficit will be neutral. We will also refrain from further increasing the minimum wage in 2017, and any increases in 2018 and thereafter will take into consideration the impact on employment, including of the youth, and competitiveness. We will also adjust the minimum subsistence level in 2017 in line with inflation. We expect our comprehensive pension reform efforts (described in paragraph 21a) to open up the necessary fiscal space for paying better pensions to the population over time. Further, we will take the following measures:

- ***Fiscal sustainability***. The increase in the minimum wage is expected to increase the wage bill of the general government to 11.3 percent of GDP in 2017, significantly above our previous plans. To ensure that the wage bill declines over time to more sustainable levels, we will accelerate fiscal structural reforms including by implementing health and education reforms to reduce the size of the public sector, comprehensive pension reform, as well as civil service reform, including by delinking the civil service wage grid from the minimum wage and revisiting the new civil service law in consultation with the EU and the IMF (see paragraph 21b).

- ***Informality***. To reduce the risks that the minimum wage increase will lead to further dropouts from the formal sector, particularly of the young and low-skilled workers, thus increasing the shadow economy, we will accelerate tax administration reforms, including by tightening the simplified tax regime, abolishing the moratorium on tax audits and labor inspections of small enterprises, increasing penalties for undeclared labor, and enhancing inspections (see paragraphs 19–20).

- ***Competitiveness***. To limit the impact of the increase in minimum wages on labor costs that could undermine competitiveness at a time that growth is still weak, we will decouple collective agreements from the minimum wage. In addition, we will accelerate productivity enhancing reforms to reduce the costs of businesses, as specified in paragraphs 27–28.

- ***Employment***. Further, we will limit any adverse impact on employment, especially of the youth, by (i) improving the system of apprenticeship through a removal of the restrictions contained in the labor code; (ii) modernizing the system of vocational training to address skill mismatches in the labor force; (iii) removing outdated norms that limit employers' ability to adjust employment to labor conditions; and (iv) limiting the scope of "protected" categories of employment by end-December 2018. More generally, in the period ahead we will proceed with a revision of our labor code to remove existing rigidities and to better adapt it to today's labor market needs by end-December 2017.

D. Fiscal Policies

18. Fiscal policy in 2017 and beyond will be anchored by our medium-term consolidation plan reflected in our IMF-supported program. Parliament adopted a budget for 2017 and supporting legislation consistent with a general government deficit ceiling of 3.1 percent of GDP (a ***prior action*** for this review). We aim to gradually reduce the general government budget deficit to 2½ percent of GDP in 2018 and 2¼ percent of GDP in 2019. This will be achieved mainly by reducing current spending, while providing for an increase in capital investment spending to improve public infrastructure. Any revenue over-performance will either be used to clear the stock of corporate income tax prepayments, further increase capital spending, or will be saved. We will also regularly review revenue sharing and expenditure assignment responsibilities between the central and subnational budgets to avoid accumulation of imbalances at the local government level.

Revenue measures

19. Further tax reform will aim to increase the efficiency and equity of the tax system. We will refrain from any major tax cuts and will not introduce new tax exemptions and amnesty schemes. We will substantially tighten the simplified tax regime from January 1, 2018, which provides a major loophole in our tax net. We will also refrain from introducing preferential tax treatment—other than for local property taxes—for companies operating in industrial zones. To allow us to efficiently implement the harmonization of filing and payment of social security contributions and personal income tax, we will submit legislation to parliament for adoption by end-April 2017. We will legalize amber mining and gambling, which should provide additional revenues to the budget not later than in 2018.

20. We will accelerate revenue administration reform to help de-shadow the economy, broaden the tax base and improve the business climate:

a. ***Transparency and accountability***. We are establishing a strong oversight and accountability framework of the MoF over the State Fiscal Service (SFS). For the first time, the MoF has established Key Performance Indicators (KPI) for the SFS, to monitor its progress in reform implementation. These KPIs will be published on a quarterly basis. In addition, to ensure integrity of the SFS information-technology (IT) operations, by end-June 2017 we will complete an external audit of SFS' IT systems and databases, and establish a strong oversight role of the MoF over SFS IT operations. To this end, by end-March 2017, the MoF will issue a resolution setting standards and goals for both the development and integrity of SFS software, the implementation of which will be monitored as a new KPI. The resolution will allow the MoF to have access to tax data in the SFS Management Information System that will not be identifiable by individual taxpayer, in an online format, as well as to have the ability to monitor and audit changes in taxpayer data. To this end, we will establish adequate audit capacity in the MoF and introduce key technological controls. We will conduct and publish semi-annual surveys of taxpayers to assess their perception of corruption at the SFS, as well as their overall assessment of the quality of SFS services.

b. ***Institutional strengthening of the SFS***. The main objectives are to increase the effectiveness, efficiency and integrity of the SFS and turn it into a service-based revenue collection organization. The full merger of tax and customs administrations into a single legal entity is expected to be completed by end-March 2017 (a new deadline for this ***structural benchmark,*** reset from end-December 2016). We will also consolidate regional tax and customs offices into a single office per region by end-March 2017. The MoF and SFS are in the process of agreeing a methodology and process for accelerating the vetting of SFS staff. Following this, a new funding model for the SFS to ensure adequate salaries for the vetted SFS staff will be adopted by end-March 2017. In order to strengthen the SFS' audit and enforcement capacity we have restored its powers to audit small- and medium-size taxpayers from January 1, 2017 and we expect parliament to adopt by end-December 2017 legislation that will grant the SFS powers to use indirect methods to ascertain tax and social security contribution obligations. The lifting of the moratorium on audits will allow the SFS to undertake more targeted inspections of companies to identify undeclared employees. We also intend to improve the quality of tax audits and establish a new, analytical risk-management unit responsible for the identification of risk criteria for the detection of non-compliance by mid-March 2017.

c. ***Reform of customs operations***. The cabinet will approve a new comprehensive customs reform strategy by end-March 2017 along with a detailed action plan, which will include the task to reduce the number of inland clearance facilities during 2017 by at least one third. We have established multi-agency mobile groups under the MoF, which have become operational since September 2016, to fight fraud and smuggling outside the border crossing points, while new inter-regional customs offices will operate at border crossing points only. We are also strengthening the SFS' partnership with the State Border Guard and have begun exchanging information in real time. To support our efforts to exchange information with major trading partners, we will approve an action plan on accession to the convention on a common transit procedure and the convention on a Single Administrative Document (SAD), and start implementing the New Computerized Transit System (NCTS) by end-2017. We will develop a control management strategy to complement the risk management strategy. By end-June 2017 the SFS will create a unified customs value reference database and build adequate capacity to ensure a regular update and analysis of prices on international markets and an effective oversight of and support to the valuation field work at the regional offices of the SFS. These efforts will be monitored by the MoF to ensure that this reference database is kept up to date and adequately reflects developments in international markets. We will publish by mid-March 2017 both the new Code of Conduct and the Anti-Corruption Program.

d. ***Reduction in compliance burden on taxpayers***. To help achieve a better image of the SFS and encourage voluntary tax compliance, a single-level dispute resolution system will become effective at SFS headquarters from March 1, 2017. We will also introduce record-keeping of outcomes of court decisions after the completion of the administrative appeals procedure. This will help us assess the effectiveness of the appeals system at the SFS. We will increase opportunities for electronic filing of tax returns, aiming that at least 70 percent of taxpayers will be filing their tax returns electronically by end-December 2017. The SFS will also improve the quality of taxpayer consultations.

e. ***Reform of financial police***. Parliament is expected to adopt legislation to establish by end-April 2017 (a new ***structural benchmark***) a new civil service responsible for investigation of financial offences against the State under the MoF to replace the current tax police and to consolidate responsibilities of fighting financial offenses against the State into a single agency, while avoiding duplication of functions. The new financial police will have a much smaller staff, the majority of which will be hired outside the current law enforcement system and will be better paid and equipped. Responsibilities of the new financial police and the SFS will be clearly delineated and we will ensure that strong cooperation exists between the two agencies. At the same time, we will maintain adequate capacity in the SFS allowing it to fight against tax fraud.

Expenditure measures

21. We will accelerate structural fiscal reforms to improve the structure of public finances and consolidate our fiscal position, while increasing the efficiency and quality of government spending:

a. ***Pension reform***. We recognize that the pension system needs to be reformed. Structural problems in the labor market (low compliance of social security contributions and low participation rates), unfavorable demographics, and outdated pension rules have eroded the sustainability of the pension system. Pension expenditure is very high, even though most individual pensions are relatively low, as the number of pensioners has grown disproportionate to the active labor force. As a result, the deficit of the pension fund has exceeded UAH 140 billion in 2016 (about 6 percent of GDP), and is set to widen further without any changes, which puts in danger the viability of the pension system in the future. To put the pension system on a sustainable basis, provide incentives for workers to contribute, and ensure adequate pensions over time, parliament will adopt by end-April 2017 a comprehensive pension reform (a new date for this delayed end-December 2016 ***structural benchmark***) that will become effective by January 1, 2018. This reform will have the following features: (i) a new set of retirement options, with a wider range of retirement ages than at present, offering an important degree of choice and dependent on total years of service, and with pension benefits that provide incentives for longer employment and later retirement; (ii) savings of at least 3 percent of GDP over the long term, including by lengthening the effective years of service at retirement; and (iii) an assurance that Ukrainian citizens have pensions that are proportionate to their contributions and adequate in real terms. This general system will apply to all categories of employment, except for a limited number of hazardous occupations. For the latter, a surcharge on social security contributions will be introduced payable by employers that is actuarially fair, which will be accumulated on personified accounts and will be used as bridge financing between the early retirement and the system described above. In addition, we will increase our efforts to expand the base for social security contributions.

b. ***Public administration and remuneration reforms***. To limit the effect from the doubling of the minimum wage in 2017, we have delinked base salaries for civil servants from the minimum wage. We have also suspended the application of the provision in the civil service law that envisaged a gradual increase in the base salary. By end-June 2017, we will undertake a comprehensive review of the overall remuneration system of the public sector taking into consideration the current legal framework and its impact on the wage structure, compression, and the overall wage bill. We will start a medium-term program of public sector downsizing and plan to reduce the size of employment in the budgetary sector (excluding the military) by at least 4 percent by end-2017, and by a further 10 percent by end-2019. In the civil service, we will continue downsizing through further optimization of ministries and other government agencies and introducing more efficient procedures, and also aim to reduce the number of staff by 5 percent by end-2017 and by a further 10 percent by end-2019. We are also building a central civil service information system and will start reporting on the number of civil servants as well as on the number of budgetary sector employees on a semi-annual basis. To monitor progress, we have established an indicative target on employment downsizing.

c. ***Healthcare reform***. We are launching deep and comprehensive healthcare reforms to increase the efficiency of spending and improve outcomes. In the first phase of the reform, we will introduce a new mechanism of financing in primary healthcare based on the principle of "money follows the patient." As a result, from July 1, 2017, primary healthcare facilities will receive budget financing based on the number of individuals registered with a chosen physician in a particular facility or a private practice. This financing will be universal and its size will vary by age. The procurement of healthcare services will be conducted by the single national purchasing agency (the National Health Service), which will be established in the first half of 2017. From 2018 the National Health Service will operate the funding for specialized and hospital care as well as outpatient pharmaceuticals. From early 2017, we will start establishing about 100 regional hospital districts within a defined territory in each oblast, thus eliminating duplication in the provision of healthcare services and building upon complementarities. This will help to significantly reduce large excess capacity in the hospital sector and improve the quality of services. In 2017, we will also introduce an outpatient drugs reimbursement program, gradually expanding the coverage of drugs.

d. ***Social assistance administration reform***. We are determined to strengthen control over the provision of social payments and improve targeting to minimize leakages to non-eligible beneficiaries. To this end, as part of the 2017 budget legislation, we have amended the legislation that will allow the MoF, in the process of verification of social payments, to access the unified database of civil status, the registry of voters, and other relevant databases. Moreover, by end-June 2017, parliament will adopt legislation to establish means testing for the recipients of all social assistance, based on households' income and assets. Based on this, we will discontinue payments to non-eligible recipients. We will also establish a single centralized database under the MoF of all recipients of social assistance and their benefits (a new ***structural benchmark*** for end-December 2017).

Institutional reforms

22. We have approved a comprehensive public finance management reform strategy for 2017-21, and have started its implementation. Under the strategy, we will ensure a full-fledged implementation of the Medium-Term Budget Framework and the strategic planning for more effective and efficient resource allocation. In order to strengthen overall fiscal discipline, we plan to develop a fiscal rule by mid-2018. We will also introduce a comprehensive fiscal risk management system and adopt the necessary legislative changes by end-December 2017 to cover and reduce macroeconomic risks, risks related to SOEs and public asset management, public guarantees, local borrowings, public-private partnerships, and other risks. To strengthen public investment management, we will implement strategic planning of public investments, create a single 'entry point' for investment proposals, and institutionalize project management by end-December 2017. We will improve the efficiency of internal control and audit functions in central and local authorities during 2017–18.

E. Energy Policies

23. We will continue our efforts to better target social assistance, improve household incentives for energy efficiency and keep spending within budget limits. To this end, we have reduced consumption norms from 5.5 to 5.0 cm per m2 for gas for individual heating, from 65 to 51 kwh per m2 for electricity used for individual heating, and from 0.0548 to 0.0431 Gcal per m2 for centralized heating effective May 1, 2017 (a delayed end-September 2016 ***structural benchmark*** and a ***prior action*** for this review). In addition, by end-July 2017, we will: (i) revise other parameters of the household utility subsidies (HUS) system to improve targeting; (ii) introduce an adjustment to the social norm for off-peak heating months; and (iii) apply a capacity-based distribution tariff for gas and heat that would shift some of the costs to the summer, all effective August 1, 2017 (a new ***structural benchmark***), thereby limiting HUS outlays to UAH 47 billion in 2017.

24. We will continue our efforts to transform the gas sector. Specifically:

a. ***To ensure that tariffs remain at full cost recovery***, we have revised the Public Service Obligations (CMU Resolution 758) to introduce an interim mechanism to automatically adjust retail gas and heating tariffs on a semi-annual basis if tariffs deviate from full cost-recovery levels (based on import parity as defined in the TMU) by 10 percent or more (a ***prior action*** for this review). The interim adjustment mechanism will remain in place until tariffs are fully liberalized. We will also adjust the price of domestic gas (UGV price) semi-annually starting April 1, 2017 to ensure that it remains in line with import prices.

b. ***To facilitate the full liberalization of gas tariffs***, by end-August 2017, we will adopt a CMU Resolution to monetize the benefits of the HUS program at the level of utility companies as of end-September 2017 (a new ***structural benchmark***), so that private gas traders can compete with Naftogaz to supply gas. We will also work toward the monetization of utility subsidies at the household level to help improve energy efficiency. Also by end-September 2017, we will further amend CMU Resolution 758 so that tariffs on gas transportation and distribution are separated from the gas cost as commodity. We will cancel the scheme that allows a 12-month installment plan to pay heating bills for households that do not receive subsidies (CMU Resolutions 630 and 357) by May 1, 2017. We will also reintroduce the sunset clause to CMU

Resolution 217 that earmarks heating company revenues for specific (non-gas) operating costs by April 1, 2017.

F. Governance, Business Climate, and State-Owned Enterprises

25. We have made progress in advancing our structural reform agenda aimed at addressing corruption, strengthening the business climate and improving governance at SOEs. We will continue with these reforms aimed at transforming our economy in the period ahead.

Anticorruption

26. We are making strides in our fight against high-level corruption, building upon the e-declaration of assets and the AML framework, and the increase in criminal investigations. Looking ahead we will focus our efforts on addressing impediments to the effective implementation of our anticorruption efforts:

a. ***E-declaration***. We have enforced the submission of the 2015 income and asset declaration by high-level officials. The submitted declarations have been made publicly available and the National Agency for Prevention of Corruption (NAPC) has reported cases of officials who did not submit a declaration to the National Anti-Corruption Bureau of Ukraine (NABU), as required by law 2014/49 (a ***prior action*** for this review). The number of high level officials that filed the asset declarations was close to 22,000 and the number of non-filers reported to NABU was 10. To monitor progress made in verifying asset declarations of high-level officials, NAPC will publish statistics on a quarterly basis starting on a webpage freely available to the public (in line with the template detailed in paragraph 98 of the TMU). In light of the unexpectedly low level of bank accounts and other assets disclosed abroad, the NBU, and the Financial Intelligence Unit (FIU) will inform their counterparts in key financial centers abroad that the absence of declaration of assets owned or beneficially owned by Politically Exposed Persons (PEPs) or their family members and associates in foreign jurisdictions may constitute a crime under Ukrainian law and a money laundering offence in these jurisdictions. Looking ahead, we will enforce the filing of comprehensive asset declarations by all high-level officials including managers of SOEs, for the calendar year 2016, as defined under Article 46 of law 2014/49, by April 1, 2017. Following this, we will evaluate the effectiveness of the asset declaration requirements to ensure that they remain appropriately focused on high-level officials and will consider amending the categories of officials that will be required to submit asset declarations.

b. ***NABU operations***. Parliament will adopt legislation to strengthen the powers of NABU in line with paragraph 36a of the September 2016 MEFP by end-May 2017 (a new deadline for this ***structural benchmark***, reset from November 2016). By end-December 2016, NABU had hired 542 staff out of its full complement of 700 staff and opened three regional offices. It started demonstrating its ability to investigate high-level officials, with 8 members of parliament, 39 judges, 23 prosecutors, and 52 SOE managers having been under investigations since the beginning of NABU operations. NABU investigations, under the supervision of the special anti-corruption prosecutor, led to more than 40 cases having been sent to court, and to the lifting of the immunity of a member of parliament in the context of an anticorruption investigation. Looking ahead, we will maintain NABU's exclusive authority to investigate acts of corruption by high-level officials. To monitor progress made in implementing the anticorruption legal framework, NABU will continue publishing statistics related to investigations of acts of corruption by high-level officials under the NABU's jurisdiction, on a webpage freely available to the public (in line with the revised template detailed in paragraph 99 of the TMU) and on a quarterly basis. By end-April 2017, the President, Parliament, and the Cabinet of Ministers will each nominate one expert for the commission of external control, in line with Article 26.6 of the NABU Law. The commission will approve the terms of reference for the annual external audit of NABU by end-June 2017, in agreement with IMF staff. Based on the analysis conducted by the auditors, the audit report will include clear and prioritized recommendations for improvements of the bureau's operations, in line with international best practices. In case auditors unanimously conclude that the criteria referred to in Article 6.4.11 of the NABU Law are met, they will include a detailed rationale and recommendation in their report. The audit report will be finalized by end-October 2017 and appended to the subsequent NABU bi-annual report.

c. ***Anticorruption court***. To ensure that prosecution of acts of corruption by senior officials receives a specialized and prioritized judicial response, we will operationalize the anticorruption court established by the June 2016 Law on the Judiciary, consistent with the European Convention of Human Rights and other standards of the Council of Europe. To this end, by mid-April 2017 we will submit relevant legislation to parliament, and we expect this legislation to be adopted by parliament by mid-June 2017 (a new ***structural benchmark***). This legislation will include provisions to ensure budgetary autonomy and adequate security of the anticorruption judiciary framework and establish the selection process for anticorruption judges. Building upon the experience with NABU and SAP, it is critical that the selection process is seen as independent and trustworthy by the public. In line with Article 33.2 of the Law on the Judiciary, specific requirements will be introduced in the proposed legislation to ensure that applicants to the position of anticorruption judges are not only of impeccable reputation, and have high professional qualities, but also possess relevant specific skills necessary to adjudicate criminal cases related to corruption. In this regard, the legislation will set out the procedure, including tests and tasks, for the assessment of the specific professional skills of applicants, which will be based on a transparent evaluation of candidates by the High Qualification Commission of Judges with the support from respected experts with recognized ethical standards and experience in anticorruption prosecution or adjudication, including potential engagement of experts with relevant experience in other countries. This procedure should be in line with the Ukrainian Constitution and the standards of the Council of Europe. The assessment of high integrity and ethical standards shall be conducted with the participation of the Civic Integrity Council as provided by the Law on the Judiciary. In line with Article 81 of the Law on the Judiciary, this selection process will ensure that for each available position, an applicant of impeccable reputation, relevant specific skills, and high professional qualities is timely selected by the High Qualification Commission of Judges, and presented by the High Council of Justice to the President of Ukraine for appointment by mid-January 2018. The anti-corruption court will begin its operations by end-March 2018.

d. ***AML implementation***. AML/CFT on-site inspections of banks targeted on the implementation of measures related to PEPs start to bear fruits, by both increasing the implementation of requirements by banks, and the suspicious transaction reporting to the FIU. The NBU has implemented enforcement actions on 13 banks since July 2016, including the revocation of a bank's license, notably for failure to implement requirements related to PEPs. In 2016, the FIU disseminated 71 cases involving PEPs to NABU, including 24 members of parliament. We will ensure that the legal and institutional measures contemplated in paragraph 36e of the September MEFP are implemented by end-March 2017. In particular, we will adopt amendments to the legal framework to ensure a three-tier reporting system: (i) suspicious transaction reports as defined by the FATF, (ii) threshold-based reporting of cash transactions and international funds transfers, and (iii) mandatory reporting of transactions related to high-risk jurisdictions and politically exposed persons, and we will strengthen the operational capacity and integrity of the Financial Intelligence Unit (FIU). In the context of amendments to the AML legal framework, we will also ensure, in agreement with Fund staff, that the definition of the persons related to PEPs is consistent with the risk-based approach encouraged by the FATF standard, and that proportionate and dissuasive sanctions can be implemented by the NBU in case of breaches of compliance with the AML framework. To monitor its contribution to anticorruption efforts, the FIU will continue publishing quarterly statistics on the information it disseminates to the NABU (in line with the template detailed in paragraph 99 of the TMU). The NBU will continue to conduct at least four quarterly inspections of banks at higher risk of laundering of the proceeds of corruption, focused on regulatory requirements related to customer due diligence and PEPs. By January 2018, when sanctions are imposed for breaches of AML/CFT requirements, the NBU will publish information on the name of the bank, the enforcement actions imposed, and a brief description of the breaches identified, while allowing case-by-case exceptions particularly where publication jeopardizes the stability of financial markets or an on-going investigation.

e. ***Business ombudsman***. Parliament is expected to adopt legislation on the Business Ombudsman in line with paragraph 36g of the September 2016 MEFP by end-March 2017. Since the start of its operations, the Business Ombudsman received more than 1,450 complaints, with a 95 percent satisfaction rate from complainants and a direct financial impact from its interventions estimated at more than UAH 8 billion.

Business climate

27. We remain firm in our efforts to improve the business climate to attract investment and boost the growth potential of our economy. Recent achievements include adoption of amendments to the law on inspections to increase the transparency and efficiency of company inspections and adoption of legislation to streamline the export of services. Further initiatives to strengthen our business environment include:

a. ***Deregulation and licensing***. The CMU has recently adopted a number of decisions abolishing a large number of regulatory acts, especially in the areas of telecommunications and agriculture. Moreover, we have revised our deregulation action plan to reflect progress to date and to refocus our efforts. In particular, we expect implementation of items 7, 8, 73, 83, and 108 of the new plan, as well as adoption of the law on the electricity market, by end-March 2017. Remaining items will be implemented in line with the commitments in the action plan. In parallel, we are conducting a rolling review of regulatory burdens in the energy, infrastructure, construction, and agriculture sectors. The CMU will adopt specific proposals for reform in each of these areas by end-April 2017. Finally, the CMU will adopt all remaining licensing conditions by end-March 2017. In this context, we will also take the necessary steps to ensure that the Single State Register of legal entities and natural persons becomes operational by end-June 2017.

b. ***Land reform***. Liberalizing the land market, including the sale of agricultural land, remains essential to boost Ukraine's growth potential. To this end, we have established a working group with relevant ministries that, in collaboration with the World Bank, will draft legislation to open up the land market and allow the sale of land under adequate safeguards. Parliamentary approval of the law on agricultural land circulation is expected by end-May 2017 (a modification and new deadline for the missed end-September 2016 ***structural benchmark***), allowing for the current moratorium on the sale of agricultural land to expire by the end of 2017, thus allowing for the sale of state-owned and private land to start immediately thereafter. We will also launch a public information campaign to explain the benefits of this reform.

State-Owned Enterprise Reform

28. Albeit with some delays, we continue to make progress with the implementation of our SOE-reform strategy. Specific near-term measures include:

a. ***Oversight of SOEs fiscal risks***. Building on recent technical assistance by the IMF, we are strengthening through adequate legislation the fiscal risks management unit in the MoF, which is tasked with monitoring and analyzing SOE fiscal risks. We will prepare an initial analysis of these fiscal risks by end-April 2017 and expect to have a comprehensive statement of fiscal risks emanating from the SOE sector included in the 2018 budget documentation and published on the MoF website.

b. ***SOE governance and reform***. Our comprehensive strategy to reform and increase the sector's efficiency includes:

   i. ***Governance***. Following adoption of the SOE corporate governance law, the CMU will adopt the decisions regulating the establishment of supervisory boards by end-March 2017. We will complete the appointment of independent supervisory boards in the largest 15 SOEs by end-June 2017. Moreover, we expect audit reports for the largest SOEs, prepared by reputable auditors that were selected on the basis of the CMU decree on criteria for auditor selection in large SOEs, to be completed by end-June 2017. We continue to explore options for the establishment of a single national Holding Company that will be tasked with managing strategic commercial SOEs.

   ii. ***Triage of all SOEs***. We continue with the triage of all SOEs in consultation with IMF staff. SOEs without a clear national strategic interest will be privatized or liquidated. By end-August 2017, the cabinet will adopt, and publish on the MoEDT website, the triage and transfer of SOEs to the State Property Fund of Ukraine (SPFU) (a new deadline for this ***structural benchmark***, reset from end-October 2016).

c. ***Liquidation of SOEs***. On the basis of the results of the triage, we plan to centralize the liquidation of non-operating SOEs under the SPFU. With this intent, the SPFU, in consultation with relevant ministries, is preparing a draft law that will enable the SPFU to liquidate SOEs with zero assets or where assets are smaller than liabilities, under streamlined procedures. In this context, we will conduct an analysis of the bankruptcy law as relevant for SOEs and introduce the necessary changes where needed. We expect parliament to adopt this draft bill by end-June 2017.

d. ***Privatization***. While we have made limited progress to date in the privatization of large SOEs, we recognize the need to accelerate this process to raise Ukraine's growth potential. Key elements in our privatization strategy include:

   i. ***Improving the legal framework***. Parliament will adopt amendments to the privatization law to improve transparency and safeguards, and to further streamline the privatization process for medium-sized enterprises by end-August 2017 (a new deadline for this ***structural benchmark***, reset from end-December 2016).

   ii. ***Creating a larger pipeline of enterprises for privatization***. Based on the triage and facilitated also by the adoption of legislation to reduce the list of companies banned from privatization, expected by end-June 2017, we will develop a schedule for transferring additional SOEs from the line ministries to the SPFU. The shares of all companies that are planned to be offered for sale in 2017 will be transferred to the SPFU by end-March 2017.

   iii. ***Privatization of small SOEs and assets***. We will streamline and accelerate the privatization of small SOEs and of thousands of small assets (buildings, machinery, etc.) currently in state hands, including by holding electronic auctions through our Prozorro system. We expect to conduct first auctions in this new platform by end-June 2017.

   iv. ***Privatization of large SOEs***. We remain committed to the privatization of PJSC Odessa Portside Plant and will implement the necessary measures, including addressing the identified balance sheet shortcomings, to attract reputable international investors and complete its privatization by the first half of 2017. In parallel, we will initiate the privatization of a number of large SOEs identified for privatization by end-September 2017, including PJSC Centrenergo, Turboatom, whose shares have already been transferred to the SPFU, and the regional energy distribution companies, obloenergos, whose shares will be transferred to the SPFU by end-April 2017. Similarly, we expect the adoption of legislation allowing for the full privatization of Ukrspirits, Ukraine's state-owned producer of spirits, which consists of about 150 related SOES, by end-March 2017, with the objective to have the contest sale completed by end-September 2017.

Table 1. Ukraine: Quantitative Criteria and Indicative Targets 1/

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

	2016						2017			
	September			December			March	June	September	December
	PC	Adj. PC	Act.	PC	Adj. PC	Act.	PC	Proposed PC	Proposed PC	Proposed PC
I. Quantitative performance criteria										
Ceiling on the cash deficit of the general government (- implies a surplus) 2/	35,000	42,212	39,451	84,900	205,014	177,769	15,000	29,000	45,000	80,970
Ceiling on the cash deficit of the general government and Naftogaz (- implies a surplus) 2/	30,500	23,977	22,208	90,000	194,692	163,328	-1,100	16,200	52,000	80,970
Floor on cumulative change in net international reserves (in millions of U.S. dollars) 3/ 4/	1,776	2,234	2,283	2,317	2,627	2,692	2,288	3,734	3,292	5,032
Ceiling on cumulative change in net domestic assets of the NBU 2/ 3/	-2,886	-10,103	-16,808	9,923	30,835	3,135	22,584	11,183	26,351	17,955
Ceiling on publicly guaranteed debt 2/	28,200	28,200	0	28,200	28,200	16,523	15,000	15,000	15,000	15,000
II. Continuous performance criterion										
Non-accumulation of new external debt payments arrears by the general government 4/	0		0	0			0	0	0	0
III. Indicative Targets										
Ceiling on cumulative change in base money 3/	25,123	25,123	19,192	46,452	72,252	45,576	58,655	n.a.	n.a.	n.a.
Inflation (mid-point, percent) 5/	n.a.		n.a.	12.0		12.4	12.0	12.0	10.0	8.0
Ceiling on stock of VAT refund arrears	0		2,566	0		494	0	0	0	0
Ceiling on current primary expenditure of the state budget 2/	n.a.		n.a.	526,000		525,647	n.a.	n.a.	n.a.	620,000
General government employment 6/	n.a.		3,340,112	n.a.		n.a.	n.a.	n.a.	3,290,011	n.a.
IV. Memorandum Items										
Naftogaz deficit (- implies a surplus) 2/	-4,500	-18,235	-17,243	5,100	-10,322	-14,441	-16,100	-12,800	7,000	0
External project financing 2/	8,965		3,691	15,858		6,758	4,000	8,000	12,000	16,000
NBU loans to DGF and operations with government bonds issued for DGF financing or banks recapitalization 3/	-635		-635	-635		25,165	455	28,027	24,979	23,599
Government bonds issued for banks recapitalization and DGF financing 3/	166,000		14,275	166,000		129,216	174,000	184,000	207,000	227,000
Programmed disbursements of international assistance except IMF (millions of U.S. dollars) 2/ 3/	1,339		1,339	2,404		1,471	2,529	2,479	2,534	4,368
Conversion of a non-reserve currency under a central bank swap line into a reserve currency through an outright sale 3/ 4/	0		0	0		0	0	0	0	0
Net financing from debt operations (millions of U.S. dollars) 3/ 4/	1,237		1,237	2,467		2,542	2,199	2,545	4,877	5,846
Projected payments of interest on government bonds held by NBU 2/	36,056		36,056	49,294		49,294	10,585	22,880	33,290	44,822
Net issuance of central government domestic FX debt 3/	455		913	-38		1,130	-99	1,000	852	701
Program accounting exchange rate, hryvnia per U.S. dollar	15.7686	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 for 2016 and 2017Q1 are specified in the Technical Memorandum of Understanding (TMU) in IMF Country Report No. 16/319 and in the TMU dated March 2, 2017 for 2017Q2 through 2017Q4.

2/ Targets for 2016 are cumulative flows from January 1, 2016. For 2017, cumulative flows from January 1, 2017.

3/ Targets for 2016 and 2017 are cumulative flows from January 1, 2016.

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

5/ End of period, year-on-year headline inflation. Mid-point within a +/- 3 percent range through 2017Q3. Mid-point within a +/- 2 percent rage in 2017Q4.

6/ Excluding salaried military personnel. Actual data reported for end-September, 2016 is as of end-June, 2016. For the end-September, 2017 test dates the reported data is for end-June, 2017.

Table 2. Ukraine: Prior Actions and Structural Benchmarks		
Prior Actions	**Status**	**Completion date**
Parliamentary approval of the 2017 budget and supporting legislation consistent with the program target of 3.1 percent of GDP (as specified in ¶18).	Met	
Resolution of all large banks that do not meet the minimum capital requirements (as specified in ¶8).	Met	
Revise the Public Service Obligations (CMU Resolution 758) to introduce an interim mechanism to automatically adjust gas and heating tariffs on a semi-annual basis if tariffs deviate from full cost-recovery levels (based on import parity as defined in the TMU) by 10 percent or more (as specified in in ¶24a).	Met	
Reduce consumption norms from 5.5 to 5.0 cm per m2 for gas for individual heating, from 65 to 51 kwh per m2 for electricity used for individual heating, and from 0.0548 to 0.0431 Gcal per m2 for centralized heating effective May 1, 2017 (as specified in ¶23).	Met	
Enforce the filing of asset declarations for 2015 by high-level officials in accordance with the law on prevention of corruption, report cases of non-filers to NABU, and make publicly available the submitted declarations (as specified in ¶26a).	Met	
Proposed New Structural Benchmarks	**Status**	**Completion date**
Selection of an international reputable firm on the basis of a transparent process, that negotiates the restructuring and collection terms of PrivatBank's impaired loans, on the basis of international best practices; and selection of a reputable international audit firm to conduct for the next two years a semi-annual independent loan review of PrivatBank's loan portfolio (in accordance with the legal and NBU regulatory framework), with the aim of properly monitoring asset value recovery (as specified in ¶8iv).		End-April 2017
Parliamentary approval of pension legislation (as specified in ¶21a).		End-April 2017
Parliamentary approval of legislation to establish a new civil service responsible for investigation of financial offences under the MoF to replace the current tax police and to consolidate responsibilities of fighting financial offenses against the State into a single agency, while avoiding duplication of functions (as specified in ¶20e).		End-April 2017
Parliamentary approval of a law on agricultural land circulation allowing for the current moratorium on the sale of agricultural land to expire by the end of 2017, thus allowing for the sale of state-owned and private land to start immediately thereafter (as specified in ¶27b).		End-May 2017

Table 2. Ukraine: Prior Actions and Structural Benchmarks (continued)		
Proposed New Structural Benchmarks	**Status**	**Completion date**
Parliamentary approval of legislation to establish an anticorruption court (as specified in ¶26c).		June 15, 2017
Revise parameters of the household utility subsidies (HUS) system to improve targeting; introduce an adjustment to the social norm for off-peak heating months; and apply a capacity-based distribution tariff for gas and heat that would shift some of the costs to the summer, all effective May 1, 2017, thereby limiting household utility subsidy outlays to UAH 47 billion in 2017 (as specified in ¶23).		End-July 2017
Adopt CMU resolution to monetize utility subsidies at the level of utility companies (as specified in ¶24b).		End-August 2017
Establish a centralized database in the MoF of recipients of social assistance (as specified in ¶21d).		End-December 2017
Previous Structural Benchmarks	**Status**	**Completion date**
Adjust the parameters of utility-related social assistance programs, including the HUS benefits formula, to ensure that benefits remain within the allocated fiscal envelope (September 2016 MEFP ¶31a).	Prior action (modified)	End-September 2016
Submit law on agricultural land circulation to parliament (September 2016 MEFP ¶38d).	Not met	End-September 2016 Modified and reset for end-May 2017
Parliament will approve amendments to legislation, consistent with IMF staff advice, to strengthen the corporate insolvency regime (September 2016 MEFP ¶20).	Not met	End-September 2016 Reset for end-September 2017
Parliament will approve a law which strengthens the provisions in the Code of Civil Procedure and the Code on Commercial Procedure on Order for Payments for domestic transaction and on garnishment of bank accounts (September 2016 MEFP ¶37).	Not met	End-September 2016 Reset for end-September 2017
Revise the Public Service Obligations (CMU Resolution 758) to introduce an interim mechanism to adjust gas and heating tariffs on a quarterly basis if tariffs deviate from full cost-recovery levels (based on import parity as defined in the TMU) by 10 percent or more (September 2016 MEFP ¶33a).	Prior action (modified)	End-October 2016
Ensure all high-level officials filed their assets and income declarations, as defined under Article 46 of law 2014/49 for the calendar year 2015 and their full disclosures freely available to the public on a single website shortly after submission (September 2016 MEFP ¶36c).	Prior action	End-October 2016
Cabinet of Ministers approval and publication in the MEDT website of the completed triage of all SOEs, dividing them into companies to (i) remain under management of the State (including SOEs that are located in territories currently not under the control of the government); (ii) privatize; or (iii) liquidate; and transfer to the SPFU those SOEs incorporated in the privatization plan for 2016 (September 2016 MEFP ¶39c).	Not met	End-October 2016 Reset for end-August 2017

Table 2. Ukraine: Prior Actions and Structural Benchmarks (concluded)

Previous Structural Benchmarks	**Status**	**Completion date**
Parliamentary approval of legislation ensuring that the NABU has: (i) the use of a wide range of investigative techniques, including undercover operations, intercepting communications, accessing computer systems and controlled delivery, without having to rely on other agencies' infrastructure; and that (ii) the registration of pre-court cases and of investigative judges' rulings pertaining to NABU should be protected from leakage of information related to ongoing investigations, by restricting access to the information to NABU and SAPO officers until the investigation of the case is completed, or the case is closed (September 2016 MEFP ¶36a).	Not met	End-November 2016 Reset for end-May 2017
Parliamentary approval of legislation to: (i) gradually adjust the statutory retirement age and further reduce the scope for early retirement; (ii) tighten the eligibility criteria for the minimum pension; (iii) consolidate pension legislation, which is now spread across about two dozen laws, and ensure a single principle for providing pensions without privileges for any occupation (with the exception of the military); (iv) expand the base for social security contributions; (v) ensure equitable tax treatment of pensions; and (vi) better link benefits to contributions, also to encourage the declaration of actual incomes. In addition, we will separate various categorical pension supplements from the labor pensions, bring their financing from the pension fund to the state budget and improve their targeting starting from 2017 (September 2016 MEFP ¶29a).	Not met	End-December 2016 Reset and modified for end-April 2017
Parliamentary approval of amendments to the privatization law to improve transparency and safeguards, and to further streamline the privatization process (September 2016 MEFP ¶39e).	Not met	End-December 2016 Reset for end-August 2017
Adopt legislation to merge the customs and tax administration into a single legal entity (September 2016 MEFP ¶27a).	Not met	End-December 2016 Reset for end-March 2017

Table 3. Ukraine: Proposed Schedule of Purchases Under the Extended Arrangement

Availability date	Amount of purchase			Conditions
	Millions of SDRs	Millions of US$ 1/	Percent of quota 2/	
March 11, 2015	3,546.00	4,872.00	258.45	Board approval of extended arrangement
June 15, 2015 3/	1,182.10	1,650.00	86.16	First review and end-March 2015 performance criteria
September 15, 2015 3/	716.11	999.80	35.60	Second review and end-December 2015 performance criteria
November 15, 2016	734.05	987.34	36.49	Third review and end-December 2016 performance criteria
May 15, 2017	1,418.48	1,906.91	70.51	Fourth review and end-March 2017 performance criteria
August 15, 2017	952.49	1,279.62	47.35	Fifth review and end-June 2017 performance criteria
November 15, 2017	952.49	1,278.81	47.35	Sixth review and end-September 2017 performance criteria
February 15, 2018	711.57	954.67	35.37	Seventh review and end-December 2017 performance criteria
May 15, 2018	711.57	954.58	35.37	Eighth review and end-March 2018 performance criteria
August 15, 2018	711.57	954.78	35.37	Ninth review and end-June 2018 performance criteria
November 15, 2018	711.57	955.15	35.37	Tenth review and end-September 2018 performance criteria
Total	12,348	16,794	614	

Source: IMF staff estimates.

1/ For 2015–18, the average USD/SDR rates used in this table are: 1.399, 1.396, 1.362, and 1.361, respectively.

2/ For 2015, Ukraine's previous quota of SDR 1,372 million applies. Ukraine's new quota of SDR 2,011.8 million became effective in February 2016. The total amount of SDR 12,348 million is equivalent to 614% of the new quota.

3/ The second purchase took place on August 4, 2015 and the third purchase took place on September 16, 2016.

Attachment II. Ukraine: Technical Memorandum of Understanding

March 2, 2017

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 March 2, 2017 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 National Bank of Ukraine (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 Chinese Yuan is valued at 0.1611 U.S. 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 accounting exchange rates are kept fixed over the program period. Therefore, the program's accounting 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 (Sixth Edition) and the Special Data Dissemination Standard (SDDS) (Table 6.1, item A). 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 they are not fully under the control of the NBU or 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 positions[1] (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[1]	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[2]
	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, 3401, 8805
	Operations with resident banks	8815
	Use of IMF credit	IMF, Finance Department

1/ 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.
2/ 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.

Assumptions in line with the authorities' commitments

8. The NIR/NDA targets assume a rollover of central government's domestic foreign exchange debt liabilities of 82 percent in 2017, respectively. The rollover will be achieved through an issuance of new central government foreign exchange bonds with a maturity of at least one year. Furthermore, the NIR/NDA targets assume that there will be no early repayment of domestic foreign exchange bonds, in line with the authorities' commitment.

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

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 (including grants and long-term credit to the NBU, while 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 or reserve assets.

- The NIR targets will be adjusted upward (downward) by the full amount of the cumulative excess (shortfall) in net issuance (gross issuance minus debt service) of central government's domestic foreign exchange debt liabilities over (under) the amounts expected under the baseline (see Table C).

- In case the NBU converts any 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 (lower) net financing from the debt operations 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 (downward) by the full amount of the cumulative excess (shortfall) in net 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 January 1, 2016, millions of U.S. dollars at program exchange rate)

	Eurobond placement	World Bank	EU	Others (Japan, Sweden, Switzerland, Turkey)	Total
End-June 2017	1,000	40	880	559	2,479
End-September 2017	1,000	70	880	584	2,534
End-December 2017	2,000	100	1,609	659	4,368

Table C. Net Issuance of Central Government Domestic FX Debt: Projections for NIR/NDA Adjustment
(Cumulative flows from January 1, 2016, millions of U.S. dollars at program exchange rate)

	Net issuance
End-June 2017	1000
End-September 2017	852
End-December 2017	701

Table D. Net Financing from Debt Operations: Projections for NIR/NDA Adjustment
(Cumulative flows from January 1, 2016, millions of U.S. dollars at program exchange rate)

	Net Financing
End-June 2017	2,545
End-September 2017	4,877
End-December 2017	5,846

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, excluding the conversion of a non-reserve currency to a reserve currency through an outright sale under a central bank swap agreement of exchange of deposits). 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.

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.[2] 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, and 3204)[3] plus funds of customers at the NBU in hryvnia (NBU liabilities accounts of groups 323,[4] 3250, 4731, 4732, 4735, 4736, 4738, 4739,

[2] 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.

[3] Previously included account 3206.

[4] 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.

and 4750), plus accrued interest on demand 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 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.

- NDA targets will be adjusted upward (downward) by the full amount of the cumulative excess (shortfall) in the total amount of NBU loans (net) 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 from Privatbank of government bonds issued for bank recapitalization (net of change in Privatbank's NBU outstanding loans since nationalization), relative to the baseline projection, and evaluated at the program exchange rates if provided in foreign exchange (Table E). For the June, September, and December 2017 targets, the combined upward adjustment is up to a cumulative maximum of the bank recapitalization and DGF financing bonds issued from January 1, 2017 and the indicative cumulative limits are derived from the relevant row of Table 1 of the MEFP.

- 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 (lower) net financing from debt operations 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 (upward) by the full amount of the cumulative excess (shortfall) in net financing in foreign exchange relative to the baseline and evaluated at the program exchange rates.

- The NDA targets will be adjusted downward (upward) by the full amount of the cumulative excess (shortfall) in rollover of central government's domestic foreign exchange debt liabilities over (under) the amounts expected under the baseline (see Table C).

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

(Cumulative flows from January 1, 2016, millions of hryvnia)

	Net NBU loans to DGF and purchases of government bonds issued for DGF Financing	NBU purchases of government bonds issued for Bank Recapitalization (net of change in NBU loans since nationalization)
End-June 2017	3,501	24,526
End-September 2017	1,834	23,146
End-December 2017	1,834	21,766

C. Headline Inflation (Indicative Target)

Definition

11. Headline inflation is defined as the year-on-year rate of change of the Consumer Price Index as measured by Ukraine's State Statistics Service. The indicative target will be considered met if headline inflation falls within a range of +/- 3 percentage points around the mid-point target by end-March, end-June and end-September 2017 and within a range of +/- 2 percentage points around the mid-point target by end-December 2017.

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

Definition

12. 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 excluding the impact of valuation changes as:

- total net treasury bill sales[5] (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 state-owned enterprises (SOE), less the cumulative total redemption of principal on treasury bills), excluding bonds issued to recapitalize Naftogaz[6] and other SOEs; plus

- 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) and the proceeds from uncompensated seizures; 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.

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

[6] 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.

13. 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. Financing changes resulting from exchange rate valuation of foreign currency deposits are excluded from the deficit. The government deposits in the banking system exclude VAT accounts used for electronic administration and escrow accounts of taxpayers used for customs clearance.

Adjustment mechanism

- The ceiling on the cash deficit of the general government is subject to an automatic adjustor based on deviations of external project loans (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.

- The ceiling on the cash deficit of the general government is subject to an automatic downward (upward) adjustment by 100 percent of the amount of the budget support grants received in excess (in short fall) of the program amounts (Table F).

Table F. External Financing of General Government Projects and Budget—Adjustment

(Cumulative flows from January 1, 2017, in millions of hryvnia)

	External project financing (Technical assumption for the adjustor purpose)	Budget support grant (Technical assumption for the adjustor purpose)
End-March 2017	4,000	0
End-June 2017	8,000	0
End-September 2017	12,000	0
End-December 2017	16,000	0

- The ceilings on the cash deficit of the general government 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 UAH 227 billion from January 1, 2016. The amount included in the targets is zero, and indicative cumulative amounts for bank recapitalization/DGF financing are presented in 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 30 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 in the territories that are temporarily outside the government control.

- The ceiling on the cash deficit of the general government will be automatically adjusted downward by VAT refund arrears accumulated as defined in Section E from January 1, 2017.

- The ceilings on the cash deficit of the general government 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 held by the NBU and an automatic upward adjustor corresponding to the increase in the budgetary interest bill arising from any recapitalization of state-owned banks and the DGF that took place after approval of the 2017 budget. Savings from any restructuring or reprofiling 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, 2017	In billions of hryvnia
End-March 2017	10.6
End-June 2017	22.9
End-September 2017	33.3
End-December 2017	44.8

14. The modalities of monitoring fiscal performance, including the adjustors listed above, can be revisited in agreement with IMF staff to ensure the achievement of the primary fiscal balance and debt targets under the program.

E. 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

- All the adjustors as specified in section E for the Cash Deficit of the General Government also apply to the general government component of this ceiling on the cash deficit of the general government and Naftogaz.
- The ceiling on the cash deficit of the general government and Naftogaz will be adjusted upward by the amount of loan 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 Ukrgazvydobuvannya and Ukrtransgaz, measured on a cumulative basis from the beginning of the year.

F. Ceiling on VAT Refund Arrears (Indicative Target)

18. The ceiling on the stock 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). This time period is 74 days, allowing for verification of the validity and payment processing of claims.

G. Ceiling on State Budget Current Primary Expenditure (Indicative Target)

19. The ceiling on the state budget current primary expenditure is defined as current cash expenditure of the general fund of the central (state) government of Ukraine net of interest payments on domestic and external debt and plus payments of any past expenditure arrears. The ceiling is based on the definition as reported in the monthly treasury report (Kv_1ek) adjusted for Ukravtodor debt repayment.

20. The ceiling on state budget current primary expenditure is subject to an automatic downward adjustor on the accumulation of new budgetary arrears on wages and social benefits

owed by the state budget. Budgetary arrears are defined as payments not made 30 days after they are due.

H. Ceiling on the Stock of General Government Employment (Indicative Target)

21. The ceiling on the stock of general government (as defined in paragraph 12), employment is defined as the number of staff positions by the general government sector excluding the military personnel receiving salaries from the state ("monetary provision"). This ceiling is set semi-annually for end-June and for end-December.

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

Definition

22. For the purposes of this performance criterion, an external debt payment arrear will be defined as a payment by the general government to nonresidents, which has not been made within the due date (including grace period, if any). This includes direct and guaranteed debt by the general government. The general government is defined for the purposes of this performance criterion in section E paragraph 12 above. For the purposes of the performance criterion on the non-accumulation of new external payments arrears by the General Government, arrears resulting from nonpayment of debt service for which a clearance framework has been agreed or for which a restructuring agreement is being sought are excluded from this definition. The performance criterion will apply on a continuous basis throughout the program period.

J. Ceiling on Publicly Guaranteed Debt (Performance Criterion)

Definition

23. The ceiling on publicly guaranteed debt will apply to the amount of guarantees issued by the central (state) government. The official exchange rate will apply to all non-UAH denominated debt. This ceiling excludes guarantees issued by the Ministry of Finance for NBU borrowings from IMF.

K. Other Continuous Performance Criteria

24. 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.

L. Key Performance Indicators for the Revenue Administration

25. The SFS will provide on a quarterly basis but no later than 25 days after the end of each quarter, data on its performance indicators included in the table below:

Quantitative Key Performance Indicators for 2016–17

Indicator	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17
	Target	Target	Target	Target	Target
Tax returns filed on time (in percent of total number of tax returns)	97.0	97.0	97.5	97.5	98.0
Taxes paid (in percent of total audit-assessed tax liabilities)	n.a.	15.0	20.0	25.0	30.0
Audits to address SSC and PIT non-compliance (total number, cumulative from the beginning of the year) 1/	9,853	2,366	4,722	7,215	10,143
Payroll tax audits (in percent of total number of audits) 1/	23	31	31	33	33
Post-clearance customs audits (total number, cumulative from the beginning of the year) 1/	335	80	170	270	380
Reduction in tax debts (percentage changed from the previous year) 2/	10.0	2.5	5.0	7.5	10.0
Number of scheduled offsite tax audits (in percent of total number of audits)	35.0	36.0	37.0	38.0	40.0
Tax returns filed electronically (in percent of total number of tax returns)	55.0	55.0	60.0	65.0	70.0
Number of taxpayer calls on corruption hotline (so called service "pulse") reviewed by SFS (in percent of total number of calls received on the hotline) 3/	100.0	100.0	100.0	100.0	100.0
The maximum amount of time needed to complete customs clearance for goods for which the customs risk assessment system (ASAUR) did not generate the need for formal procedures (in minutes) 4/					
Import	*115.0*	*105.0*	*95.0*	*85.0*	*75.0*
Export	*45.0*	*45.0*	*40.0*	*35.0*	*30.0*
Transit	*18.0*	*18.0*	*17.0*	*16.0*	*15.0*
Number of customs declarations for which discrepancies have been actually established (in percent of total number of customs declarations identified by ASAUR as risky)	n.a.	1.0	2.0	3.0	4.0
Cap on the number of customs declarations that are subject to audit (in percent of total number of suspected cases identified outside the ASAUR system)	n.a.	1.0	2.0	3.0	3.5
VAT refund arrears (in UAH billions)	0.0	0.0	0.0	0.0	0.0
Total assessed and due liabilities paid (percent)	n.a.	93.5	94.0	94.5	95.0

1/ For end-2016 data are actuals.
2/ The targeted reduction is relative to the stock that does not include debt accumulated in the course of the year.
3/ Service "pulse" is an anti-corruption portal of SFS.
4/ Data for 2015 is the average for 4th quarter, for 2016 is the average for the second half.

II. Official Exchange Rate

Determination of the Official Exchange Rate

26. 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 until 5:30 pm 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. Cost Recovery of Gas and Heating Tariffs

27. The threshold deviation from cost recovery based on import parity to trigger an automatic adjustment each half-year of gas year (April 1, October 1) in retail gas and heating tariffs will apply to the retail gas price, which includes the appropriate transmission costs (Ukrtransgas), distribution costs (oblgases), provider markup, in effect at the date of calculation as officially published by the regulator and VAT. The date of calculation shall be two months prior to the effective date of the adjustment. The import parity shall be calculated based on monthly average German gas hub (NCG) prices, transmission and entry costs multiplied by monthly average exchange rates of USD/EUR "spot" and recalculated in UAH at the average exchange rate per NBU for the last 2 months of the calculation period. Calculation period for the import parity calculation cannot exceed 12 months and is defined since the last retail gas prices determination date to the month preceding the calculation date for the first calculation, and further since the month preceding the last calculation date to the month preceding the next calculation date.

IV. Reporting Requirements

A. National Bank of Ukraine

28. The NBU will continue to provide to the IMF on a monthly basis sectoral balance sheets for the NBU and other depository corporations (banks) according to the standardized reporting forms (SRFs), no later than the 25th day of the following month.

29. 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 the full breakdown of NBU accounts included in net international reserves (defined in Table A above) any additional information that is needed for the IMF staff to monitor developments in net and gross international reserves. On a monthly basis, no later than the 25th of the following month, the currency composition of reserve assets and liabilities.

30. The NBU will provide the IMF on a daily basis with information on obligatory, voluntary and total foreign exchange sales (including total from nonresidents and sales by clients in the interbank market) 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.

31. 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."

32. 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; 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.

33. The NBU will provide information on daily transactions (volumes and yields) on the secondary market treasury bills (including over-the-counter transactions and with a breakout for any NBU transactions).

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

35. The NBU will continue to provide to the IMF daily and monthly data on the NBU financing operations (including swaps or 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 formats and timeliness 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 and monthly reporting of NBU loans and collateral will separately identify which banks are under temporary administration or liquidation.

36. 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 indicators in the format agreed with the IMF staff. The NBU will also provide core and expanded FSIs, as defined in the IMF

Compilation Guide, for the aggregate as well as individual banks in State Participation Group Foreign Banking Group and Group 1.

37. On a daily basis and on a monthly basis within three weeks following the end of the month, the NBU will continue to provide the IMF with the depository corporations surveys, including any additional information that is needed for the IMF staff to monitor monetary policy and developments in the banking sector, in particular: net domestic assets, including NBU loans and liabilities with banks and 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 and the DGF, 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) and DGF.

38. 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.

39. 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.

40. 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+n verification system (with n determined by the latest NBU resolution), 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).

41. 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 assets and foreign liabilities (broken down by domestic and foreign currency) for the individual banks in State Participation Group, Foreign Banking Group and Group 1. 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.

42. The NBU will provide, on a daily basis, bank-by-bank data for the largest 35 banks and aggregate data for the State Participation Group, Foreign Banking Group, Group 1 and Group 2 separately (all excluding banks in temporary administration) 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. The NBU will also provide, on a daily basis, bank-by-bank data for State Participation Group, Foreign Banking Group, and Group 1 banks and aggregate for Group 2, 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 groups of banks, the NBU will provide data on deposits and credits excluding those banks in liquidation since 2014.

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

44. The NBU will provide to the IMF with information on reserve requirements.

45. The NBU will provide the IMF, on a monthly basis, bank-by-bank for State Participation Group, Foreign Banking Group and Group 1 banks the average interest rate on deposits to customers (by domestic and foreign currency, and legal entities and households, and by maturity—demand, savings, and time accounts); and on a weekly basis, the average interest rate on interbank borrowings (by domestic and foreign currency, and by maturity—overnight, 1–7 days, and over one week).

46. The NBU will provide the IMF, on a two weekly basis, in an agreed format, data for the entire banking sector—aggregate for Group 2 and on a bank-by-bank basis for State Participation Group, Foreign Banking Group and Group 1 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.

47. The NBU will provide the IMF, on a monthly basis, in an agreed format, data for the entire banking sector—aggregates for Group 2 and on a bank-by-bank basis for State Participation Group, Foreign Banking Group and Group 1 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).

48. The NBU will provide the IMF, on a monthly basis, in an agreed format, bank-by-bank for the State Participation Group, Foreign Banking Group and Group 1 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).

49. The NBU will provide to the IMF, on a monthly basis, aggregate and bank-by-bank and by region data on 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).

50. The NBU will report to the IMF, on a monthly basis, data for the entire banking sector (and aggregates for Group 2) as well as on a bank-by-bank basis for State Participation Group, Foreign Banking Group and Group 1 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.

51. Upon request, the NBU will provide to the IMF the two-week projections of bank-by-bank cash flows for the State Participation Group, Foreign Banking Group and Group 1 banks.

52. The NBU will report to the IMF on a bi-weekly basis and bank-by-bank the amount by which the State Participation Group, Foreign Banking Group and Group 1 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.)

53. 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 related or connected lending, as well as about decisions on declaring a bank as problem or insolvent.

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

55. 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.

56. 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.

57. The NBU will inform IMF staff of any changes to reserve requirements for other depository corporations.

58. 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.

59. 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.

60. 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.

61. The NBU will provide the Fund with data relative to the interest income and principal received from January 1, 2016 on its portfolio of government bonds on a monthly basis but no later than 15 days from the end of the reporting period. Monthly, the NBU will also provide data on the monthly coupons and principal to be paid (in hryvnia and foreign currency, separately) on the outstanding stock of government securities held by NBU and the public.

B. Deposit Guarantee Fund

62. 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.

63. 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.

64. 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.

65. 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.

66. 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.

67. 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

68. 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.

69. 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.

70. 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.

71. 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.

72. 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.

73. 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.

74. 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.

75. 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.

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

77. 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, DGF, 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.

78. 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.

79. The Ministry of Finance will report data on the general government employment levels by sector. The report will be provided semi-annually, no later than April 1 and October 1 on the employment levels as of January 1 and July 1 of the same year, respectively. 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. The report on the employment levels will be provided in the following format:

	The maximum number of staff positions, units	Number of actual staff employed (including contractual), units	Total wage bill (incl. social security contributions), in UAH millions	Average monthly wage (UAH)
Healthcare				
Physical culture and sports				
Social assistance and social protection				
Education				
Culture				
Science				
Other activities				
Judiciary				
Local administrations				
Central government bodies (including territorial bodies)				
Pension fund				
Diplomatic installments				
Prosecutor's office				
Defense				
Public Order and Security				
Local self-governance bodies				
Total				

80. 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.

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

82. 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										

83. 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.

84. 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.

85. 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.

86. 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 Economic Development and Trade, Ministry of Energy and Coal Industry, Ministry of Housing and Municipal Economy of Ukraine, National Commission in Charge of State Regulation in Energy and Utilities (NCSREU), and Naftogaz

87. The Ministry of Regional Development, Construction, and Housing and Municipal 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 Economic Development and Trade and the NCSREU will provide the methodology underlying the tariff calculations for full cost recovery, including heating and gas.

88. 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 Economic Development and Trade, 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.

89. For each month, no later than the 25th of the following month, the Ministry of Economic Development and Trade (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.

90. For each month, no later than the 25th of the following month, the Ministry of Economic Development and Trade (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 "Ukrgasvydobuvannya," and OJSC "Ukrnafta."

91. 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.

92. 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).

93. 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.

94. NJSC Naftogaz will report on a weekly basis data on Naftogaz daily market purchases of foreign exchange.

95. 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

96. 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

97. 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.

G. National Agency for Prevention of Corruption

98. The National Agency for Prevention of Corruption (NAPC) will publish on a website freely available to the public quarterly data, no later than at the end of the month following the quarter, on the action taken regarding the asset declaration of high level officials, in the following format:

Number of Full Verifications of Asset declarations by the NAPC
(Article 50 Law on Prevention of Corruption)

	Members of Parliament, Members of the Government	Judges	Prosecutors	Category A Civil Servants	SOE Managers	Others
Number						

Reports sent by the NAPC to NABU

	Members of Parliament, Members of the Government	Judges	Prosecutors	Category A Civil Servants	SOE Managers	Others
Number of reports for absence of declaration						
Number of reports for false declaration						

H. National Anti-Corruption Bureau

99. The National Anti-Corruption Bureau (NABU) will publish on a website freely available to the public quarterly data, no later than at the end of the month following the quarter, on the number of persons indicted, the number of persons convicted by a first instance court decision, and the number of persons convicted pursuant a final court decision, in the following format:

Number of Persons Indicted

Penal Code Article	Members of Parliament, Members of the Government	Judges	Prosecutors	Category A Civil Servants	SOE Managers	Others
Art. 191						
Art. 206-2						
Art. 209						
Art. 210						
Art. 211						
Art. 354						
Art. 364						
Art. 368						
Art. 368-2						
Art. 369						
Art. 369-2						
Art. 410						

Number of Persons Convicted—First Instance

Penal Code Article	Members of Parliament, Members of the Government		Judges		Prosecutors		Category A Civil Servants		SOE Managers		Others	
	Fine	Jail	Fine	Jail	Fine	Jail	Fine	Jail	Fine	Jail	Fine	Jail
Art. 191												
Art. 206-2												
Art. 209												
Art. 210												
Art. 211												
Art. 354												
Art. 364												
Art. 368												
Art. 368-2												
Art. 369												
Art. 369-2												
Art. 410												

For fines, total value in UAH. For jail, total months (and suspended jail).

Number of Persons Convicted—Final Decision

Penal Code Article	Members of Parliament, Members of the Government		Judges		Prosecutors		Category A Civil Servants		SOE Managers		Others	
	Fine	Jail	Fine	Jail	Fine	Jail	Fine	Jail	Fine	Jail	Fine	Jail
Art. 191												
Art. 206-2												
Art. 209												
Art. 210												
Art. 211												
Art. 354												
Art. 364												
Art. 368												
Art. 368-2												
Art. 369												
Art. 369-2												
Art. 410												

For fines, total value in UAH. For jail, total months (and suspended jail).

I. Financial Intelligence Unit

100. The Financial Intelligence Unit (FIU) will continue to publish on a website freely available to the public quarterly data, no later than at the end of the month following the quarter, information on reports sent to NABU in relation to suspicions of laundering of the proceeds of corruption, in the following format:

Reports sent by the FIU to NABU

	Members of Parliament, Members of the Government	Judges	Prosecutors	Category A Civil Servants	SOE Managers	Others
Number of reports disseminated						
Aggregated value of suspected money laundering						

INTERNATIONAL MONETARY FUND

UKRAINE

March 7, 2017

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION AND THIRD REVIEW UNDER THE EXTENDED FUND FACILITY AND REQUESTS FOR REPHASING OF ACCESS AND FINANCING ASSURANCES REVIEW—INFORMATIONAL ANNEX

Prepared By	European Department in consultation with other departments

CONTENTS

FUND RELATIONS

(As of January 31, 2017)

SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	1,309.44	100.00
Holdings	2,011.30	153.60

Outstanding Purchases and Loans:	**SDR Million**	**%Quota**
Stand-by Arrangements	2,972.67	147.76
Extended Arrangements	5,444.21	270.61

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
EFF	03/11/15	03/10/19	12,348.00	5,444.21
Stand-By	04/30/14	03/10/15	10,976.00	2,972.67
Stand-By	07/28/10	12/27/12	10,000.00	2,250.00

Projected Payments to Fund:[1]

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2017	2018	2019	2020	2021
Principal	628.83	1,486.34	1,153.00	788.02	907.37
Charges/Interest	193.87	163.88	117.39	85.23	55.26
Total	**822.71**	**1,650.21**	**1,270.39**	**873.25**	**962.63**

Exchange Arrangements:

In September 1996, the authorities introduced the hryvnia (UAH) at a conversion rate with the previous currency karbovanets (Krb) of KrB 100,000 to UAH 1. The monetary policy strategy for 2016–20 calls for the National Bank of Ukraine (NBU) to maintain a floating exchange rate arrangement, meaning that monetary policy will not be aimed at achieving a certain exchange rate target or range. At the same time, the NBU will use foreign currency interventions for the purpose of accumulation of international reserves, smoothing out the functioning of the foreign exchange market, and maintaining the transmission of the key interest as the core monetary policy instrument. Effective March 31, 2015, the NBU sets the official hryvnia–U.S. dollar exchange rate, which takes effect on the following day, as a weighted average rate of the hryvnia against the U.S. dollar based on all the foreign exchange deals concluded between banks and their clients on the current day on tod, tom, and spot terms, regardless of the value date.

[1] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

On September 24, 1996, Ukraine accepted the obligations of Article VIII, Sections 2, 3 and 4 of the Fund's Articles of Agreement. Ukraine maintains exchange restrictions and multiple currency practices subject to Fund approval under Article VIII: The exchange restrictions arise from (i) absolute limits on the availability of foreign exchange for certain nontrade current international transactions; and (ii) a partial ban on the transfer abroad of dividends received by nonresident investors from investments in Ukraine. The multiple currency practices arise from: (i) the use of multiple price foreign exchange auctions conducted by the NBU without a mechanism to prevent a deviation of more than 2 percent between the auction rates and the market exchange rate at the time of the auction; (ii) the requirement to transfer the positive difference between the sale and purchase price of foreign exchange to the state budget if the purchased foreign exchange is not used within 10 days and is resold; and (iii) the use of the official rate for government transactions without establishing a mechanism to ensure that the official rate does not deviate from the market rate by more than 2 percent.

FSAP Participation:

A joint World Bank-International Monetary Fund mission conducted an assessment of Ukraine's financial sector as part of the Financial Sector Assessment Program (FSAP) in 2003, and the Financial Sector Stability Assessment (FSSA) report (IMF Country Report No. 03/340) was considered by the Executive Board on May 14, 2003. The observance of the following standards and codes was assessed: Basel Core Principles for Effective Banking Supervision; Code of Good Practices on Transparency in Monetary and Financial Policies; CPSS Core Principles for Systemically Important Payment Systems; OECD Principles for Corporate Governance; Accounting and Auditing Practices; World Bank's Principles and Guidelines for Effective Insolvency and Creditor Rights System; and AML/CFT Methodology.

An FSAP update was undertaken in 2007. The observance of the following standards and codes was assessed: Basel Core Principles for Effective Banking Supervision; and IOSCO Core Principles of Securities Regulation. A Financial Sector Stability Assessment (FSSA) was considered by the Executive Board as part of the 2008 Article IV consultation.

ROSCS:

A Data ROSC Module was conducted in April 3–17, 2002, and was considered by the Executive Board on August 5, 2003 (IMF Country Report No. 03/256). A Fiscal Transparency Module (experimental) was issued in September 1999, and an update in April 2004 (IMF Country Report No. 04/98).

Safeguards Assessments:

An update safeguards assessment was completed on August 14, 2015. It confirmed that the NBU had made progress in strengthening its governance and control environment since the previous assessment conducted in 2014. In particular, amendments to the legal framework to enhance NBU's governance and autonomy in line with recommendations from the Fund entered into force in July 2015. A new Council was established in November 2016 and constituted an Audit Committee to provide independent oversight on audit mechanisms and internal controls. Progress has also been made in addressing other safeguards recommendations. In particular, the loan origination and management process has been enhanced and the NBU established a senior-level credit committee in June 2015 to oversee lending to financial institutions. In addition, quarterly data audits are ongoing with the results timely conveyed to the IMF.

UFR/Article IV Consultation:

Ukraine is on a 24-month consultation cycle. The last Article IV consultation was concluded on December 16, 2013 and a report was published on our external website: www.imf.org.

IMF Technical Assistance:

IMF Technical Assistance 2014–16

Fiscal Affairs Department

Area	Topic	Dates
Tax Policy	Staff visit on tax policy	6/2014, 6/2015
	Restoring a Strategic Approach to Tax Reform	9/2014
	Review of the Extractive Industries Fiscal Regimes	11/2014
	Extractive Industries: Petroleum Fiscal Regime and Associated Legal Design Issues, and Tax Admin	3/2015
	Transfer Pricing	3/2015
	Fiscal Regime for Natural Gas	6/2015, 4/2016
	Reducing S.S. Contributions and Improving Corporate and Small Business Tax System	7/2015
Revenue Administration	Tax Administration Reform and Governance Options	6/2014
	Staff visit on revenue administration	11/2014
	Capacity in Oil and Gas Administration	6/2015, 3/2016, 9/2016
	Reforming the State Fiscal Service	7/2015, 7/2016, 11/2016
	Staff visit on scoping for RA-GAP	12/2015
	Customs Administration	1/2016, 9/2016
Expenditure Policy	Expenditure Rationalization	5/2014, 4/2015
	Strengthening Social Assistance in Support of Energy Subsidy Reform	1/2015, 4/2015
	Pension reform	1/2015, 5/2015
PFM	Public Financial Management Overview	7/2014
	Fiscal Decentralization	11/2014
	Reforming Management and Oversight of State Assets	2/2015
	Expenditure Review and Rationalization	7/2015
	Developing the Spending Review Process and Assessing SOE Reform	11/2015
	Public Investment Management Assessment	4/2016

Monetary and Capital Markets Department

Area	Topic	Dates
Accounting	IFRS Related TA Mission	10/2014
	Accounting and Auditing	2/2016, 6/2016
Bank Restructuring	Resolving Systemic Banks	1/2016, 3/2016, 10/2016
	Bank Contingency Planning	10/2015
	Steering Committee Meeting on Bank Diagnostics	8/2014, 9/2015, 10/2015
	Bank Recapitalization and Resolution Costs	11/2014
	Related Party Identification and Monitoring	2/2015, 12/2015
	Banking Sector Restructuring and Reform	4/2014
	Due Diligence Review for Banks	9/2014
	Bank Resolution	10/2014
Bank Supervision	Bank Licensing	1/2016, 3/2016
	Central Credit Registry	12/2015, 12/2016
	Managing the State Participation on Banks	4/2016, 12/2016
	Credit Risk—Regulatory provisioning for banks	2/2016
	Reporting and Auditing of Related Parties Exposure	4/2015
	Governance at the Ministry of Finance	8/2014
	Early Identification of Problem Banks	10/2014
	Needs Assessment in the Area of Banking Supervision	9/2015
Capital Markets Develop.	Assistance to the National Securities and Stock Market	1/2016, 4/2016, 12/2016
	Reform of the Securities Market	5/2015, 7/2015
	Debt Management	4/2016
Central Bank Organization	Central Bank Operations	5/2014, 7/2014, 8/2014
	Central Bank Reorganization	11/2014, 6/2016
	Development of NBU Research Function	7/2015, 12/2015
Cross Border Flows	Reform of the NBU Law	11/2014
Financial Stability	Stress Testing	3/2014, 6/2014, 6/2015, 8/2015
Monetary Policy Operations	Monetary Operations and Money Market Development	5/2014, 7/2014
	Foreign Exchange Operations	9/2014
	Monetary Policy Communication	12/2014, 7/2015, 12/2015
	Monetary Policy and Operations	2/2015, 3/2016
	Emergency Liquidity Assistance	6/2016
	Modeling and Central Bank Operations	11/2016

Legal Department

Area	Topic	Dates
	Central Banking	11/2014
	Fiscal Law—Tax	3/2015, 7/2015
	AML to Support Anti-Corruption Efforts	5/2015, 6/2015, 10/2015, 11/2015, 12/2015, 2/2016, 3/2016, 6/2016, 10/2016, 12/2016
	New Legislation on Orders of Payments	6/2016
	Fiscal Law—Non-Tax	10/2016

Statistics Department

Area	Topic	Dates
	National Accounts	9/2014
	Prices	6/2015, 8/2016

RELATIONS WITH THE WORLD BANK

(January 2017)

Country Partnership Strategy and World Bank Program

The World Bank Group's Country Partnership Strategy (CPS), 2012–16 aimed to assist Ukraine in making progress on its reform and EU integration agenda and was organized around two pillars. The first pillar aimed to support deepened relations between government and citizens, focused on improving public services, including a more sustainable, efficient, transparent, and accountable use of public resources. The second pillar aimed to support more productive cooperation between government and business by focusing on growth, competitiveness and job creation, including improvements in the business climate and public investment in critical infrastructure.

The 2012–16 CPS was faced with supporting Ukraine in responding to the unprecedented double shocks from the conflict in the East of Ukraine and the decline in global commodity prices. From May 2014 to June 2016, the World Bank Group committed $4.6 billion in new support to Ukraine, including $2.2 billion in investment project financing, $2.25 billion in two series of development policy operations (DPOs) to advance critical structural reforms, and $250 million in International Finance Corporation (IFC) investments in the private sector.

The two series of DPOs, in coordination with the new IMF program, supported Ukraine in adopting critical, longstanding structural reforms in the face of unprecedented shocks. These reforms and results include: undertaking significant fiscal consolidation and moving to flexible exchange rate; reform energy tariffs to reduce a key source of rents and quasi-fiscal deficit and strengthen the social safety net system to cushion the impact on the poor; stabilizing the banking sector by putting in place the framework to resolve and recapitalize banks, strengthen supervision, and address the long-standing problem of related-party lending; streamlining the business environment by easing registration, licensing, and permitting requirements and establishing a deregulation framework; improving efficiency and accountability in the use of public resources by making public procurement more transparent, strengthening external audit, and improving public investment management; and putting in place key instruments of anticorruption.

The current investment lending portfolio includes eight operations totaling $2.62 billion, of which only 18.7 percent has been disbursed. These include: the Social Safety Net Modernization Project ($300 million, approved in July 2014); the Serving People Improving Health Project ($214.7 million, approved in March 2015); the Second Power Transmission Project ($330 million, approved in December 2014); the Energy Efficiency Project ($200 million, approved in 2011); the District Heating Energy Efficiency Project ($265.5 million, approved in May 2014, now restructured); the Second Urban Infrastructure Project ($300 million, approved in May 2014); the Second Road and Safety Improvement Project ($450 million, approved in 2012); and the Road Sector Development Project ($560 million, approved in November 2015). In addition, the Gas Supply Security Facility ($500 million in IBRD guarantee) was approved by the Board in October 2016.

The new Country Partnership Framework (CPF) for the period 2017–21 is being prepared by the WBG in close consultation with key stakeholders.

All areas of Bank engagement are built on strong diagnostic work and technical assistance, with focus on building consensus in society regarding policies and processes to tackle key structural challenges. Moving forward, the main areas for advisory services and analytical work (ASA) are expected to focus on: (i) anticorruption, state capture, and public financial management (PFM); (ii) fiscal sustainability and efficiency, including programmatic public finance reviews covering key areas; (iii) financial sector stability and development; (iv) energy efficiency and governance (including gas sector modernization); (v) the investment climate, including advice in key policy areas such as agriculture, land, and business regulations; (vi) municipal governance and service delivery; (vii) social protection including pensions and social assistance; (viii) health sector; and (ix) support for peacebuilding and conflict affected populations. Partnerships and coalitions on policy dialogue and ASA with other development partners, including the European Commission (EC), the International Monetary Fund (IMF), the UK Department for International Development (DFID), the U.S. Agency for International Development (USAID), European Bank for Reconstruction and Development (EBRD), and other bilateral donors will continue and be expanded as much as possible.

Bank-Fund Collaboration

According to Joint Management Action Plan on Fund-Bank collaboration on Ukraine, the staff teams agreed that the Fund and the Bank would coordinate in monitoring macroeconomic and fiscal developments and collaborate in supporting Ukraine's efforts to: (i) strengthen institutions of better governance and anticorruption; (ii) safeguard fiscal sustainability; (iii) maintain financial sector stability; (iv) bolster private sector competitiveness; and (v) improve effectiveness of social services and assistance. The teams agreed to the following division of labor and coordination:

- ***Macroeconomic and fiscal monitoring***. The Fund and the Bank coordinate in monitoring macroeconomic and fiscal developments and in assessing the medium-term macroeconomic framework. This includes sharing information and assessments of recent developments and prospects for economic growth, fiscal and external balances, and the macroeconomic implications of structural reforms.

- ***Strengthening anticorruption institutions***. Corruption and weak governance constitute a dominant impediment to Ukraine's development prospects. The Bank and the Fund are thus coordinating in supporting Ukraine's efforts to strengthen institutions of transparency and accountability, including in the areas of anticorruption, public financial management, and citizen's engagement. The Bank and the Fund are collaborating in supporting effective implementation of recently adopted anticorruption legislation, including electronic asset declarations and their external verification. The Bank has also supported the government in preparing a new Public Financial Management (PFM) reform strategy and plans to provide technical assistance on implementation in key areas including medium-term budgeting.

- ***Safeguarding fiscal sustainability***. While Ukraine has made significant progress in reducing large fiscal imbalances, medium-term fiscal pressures are considerable. The Bank and the Fund have coordinated in supporting Ukraine's fiscal consolidation efforts during 2014–16 through energy tariff and social assistance reform, expenditure restraint, and revenue measures. Going forward, further coordination in supporting reforms to the tax and pensions systems will be important in safeguarding fiscal sustainability. Tax reform will require strengthening tax administration, reducing exemptions, and improving international taxation arrangements. Pension reform options include restructuring the overall benefit package to improve adequacy of old-age benefits while reducing the medium-term deficit, as well as parametric measures related to the retirement age, early retirement, and categorical benefits.

- ***Maintaining financial sector stability***. The economic downturn has put Ukraine's banking sector under significant stress, which has been amplified by underlying structural weaknesses. The Bank and the Fund have coordinated in supporting the authorities to put in place a framework to resolve and recapitalize banks and strengthen supervision. In light of persisting vulnerabilities, further coordination in supporting sound implementation of the framework will be important. Furthermore, a resumption of credit growth will also require coordination in supporting reforms to resolve non-performing loans (NPLs) and strengthen corporate governance of state owned banks.

- ***Bolstering private sector competitiveness***. The competitiveness of Ukraine's private sector is held back by a number of factors, including inadequate infrastructure, a concentrated production structure that limits competition, and the lack of a land market along with weak land administration and management that constrains agriculture and other sectors. In supporting Ukraine's efforts to bolster competitiveness, the Bank is providing technical assistance on reforms in the areas of streamlining the regulatory environment, strengthening implementation of the competition framework, state-owned enterprises, and reforming land markets and management. The Bank and Fund teams will work closely to support implementation of this reform agenda.

- ***Improving effectiveness of social services and assistance***. Education, health, and social assistance in Ukraine are characterized by high levels of expenditure but weak and ineffective service delivery and poorly targeted assistance. Improving the effectiveness of social services can help build human capital, improve employment outcomes, and reduce dependence on transfers. The Bank's public expenditure analyses on health, education, and social assistance is providing technical support in assessing challenges and opportunities for reform in these areas. The ongoing health project is well placed to support implementation of the recently endorsed health reform plan, which includes a shift in focus from hospitals to primary care and improvements in the health financing model. The Bank's social safety net modernization project is supporting efforts to improve targeting. The Bank and Fund teams will work closely to support implementation of this reform agenda.

World Bank Contact: Faruk Khan, Lead Economist and Program Leader; Anastasia Golovach, Economist (Tel.: 380-44-490-6671).

RELATIONS WITH THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT

(December 2016)

Since Ukraine joined the EBRD in 1992, the Bank has been active in supporting the country's transformation towards market economy. As of end-November 2016, the EBRD's portfolio in Ukraine reached €4.3 billion with almost half of it being in the private sector. In the first 11 months of 2016, disbursements accelerated to €802 million—the highest rate since 2009 and up from €247 million in the same period of 2015. The Bank's country exposure in Ukraine is its third largest after Turkey and Russia, accounting for approximately 1/10th of the Bank's overall portfolio. The portfolio represents roughly an equal exposure across the Bank's three main sectors: Industry, Commerce & Agribusiness, Financial Institutions and Energy & Infrastructure. In Ukraine's current context, the Bank is seeking to maintain the pace of its investments, capacity building and policy dialogue to provide support for economic stabilization and growth, while targeting continued impact on the country's transition to a sustainable market economy.

As a response to the crisis that engulfed Ukraine in late 2013, the EBRD has been providing comprehensive support to Ukraine under the strategic framework of its 'Reform Anchoring & Crisis Response Package.' The package is based on the following three priorities: 1) banking sector stabilization and restructuring; 2) energy security and energy sector reforms; 3) financing of key private corporate players. Since early 2014, EBRD has been able to step up its engagement in Ukraine in view of the authorities' willingness to implement broad-ranging reforms, while remaining cautious of the heightened risks in the operational environment. In 2014, despite the increased country risk, the EBRD invested €1.2 billion in Ukraine, a record level for the country. This was followed by new investments amounting to €997 million in 2015 and further €253 million in the first 11 months of 2016. From 2014 to November 2016, EBRD invested a total of €455 million into energy sector, €796 million into financial institutions, €810 million into industry, commerce and agribusiness and €400 million into infrastructure sector.

The EBRD supports FDI and local enterprises to help diversify the economy and restructure old energy-intensive industries with a focus on improving governance, transparency and energy efficiency. The Bank has been active in developing the local private sector and encouraging inflows of FDIs. It has supported a number of medium and large local clients. Small and medium-size enterprises have been reached via credit lines offered to them via partner banks and also through direct financing. The Bank has actively participated in financing several leading international investors (including Air Liquide and Louis Dreyfus) and cross-border transactions with sponsors from other countries of operation.

In 2014, the EBRD launched its Small Business Initiative, with an objective to provide SMEs with better access to finance and to render support to the SME sector in an efficient and holistic approach manner that encompasses direct and indirect finance products, advisory services and policy dialogue. Small Business Initiative is structured along two main pillars—Advice for Small Businesses and SME Finance. *Advice for Small Businesses* aims at increasing SME competitiveness through cost sharing for engagement of local consultants and international industry advisers to address specific enterprise needs and through implementing sector-specific development activities. Special initiatives like *Export Promotion and Women in Business* aim at improving export strategies and marketing for local SMEs as well as empowering women-led enterprises. To date, 690 projects were started under Advice for Small Businesses program, of which 140 projects with local consultants and 14 projects with international advisers were launched in 2016. *Financing* to SMEs is provided indirectly via financial institutions, through risk sharing with financial institutions, direct finance (debt and equity), as well as Trade Facilitation Program that also works via partner banks. In 2016, seven direct financing deals were signed. In May 2016, the European Union and the EBRD signed an agreement on providing up to €28 million for business advice, information, training and other support to SMEs in Ukraine under the EU4Business program. This assistance will include the creation of 15 business support centers in the regions of Ukraine. Up to €12 million of EU4Business funds will be used to support the EBRD's direct financing of SMEs via investment preparation and due diligence support.

Since 2014 the EBRD has been actively working with the Ukrainian authorities to facilitate essential reforms in the country's financial system. The EBRD supported the NBU in a major cleanup of the banking system by contributing to development and approval of key laws aimed at preventing improper business practices, increasing transparency and promoting fair competition among banks, targeting: (1) full disclosure of true beneficial ownership; (2) economic definition of related parties and monitoring of bank exposures by the NBU, and (3) personal responsibility of bank owners for related-party lending and fraud. Together with other IFIs, the Bank played a key role in the preparation of the strategy for state-owned banks' development, aiming at improving their corporate governance, commercialization of operations, and future privatization. EBRD provided advice to the government on new legislation for corporate governance of SOBs and entered into strategic cooperation with Oschadbank and MinFin to promote the bank's transformation through investment and technical cooperation. The EBRD is also involved in strategic advice and institutional capacity building of the Deposit Guarantee Fund through a comprehensive technical assistance program targeted at improving its operational and asset sale and valuation activities. Targeted expert advice has been provided to the NBU in the areas of capital stress testing, monetary policy, and problem bank resolution, as well as development of legislative and regulatory framework for the nonbank financial institutions and asset resolution companies. The EBRD has led the process the development, approval and rollout (expected in 2017) of the Financial Restructuring Law (the Kiev Approach) establishing a framework for out-of-court problem debt restructuring. Work has continued on the comprehensive derivatives legislation, which has been approved in first reading by the Rada. The Bank plans to expand its activities into supporting a joint project management office for financial sector reform at the NBU and NSSMC.

The EBRD’s investment in the financial sector has focused on providing equity capital and trade financing. Senior lending activity has remained subdued due to low market demand, but is expected to grow, in part due to anticipated launch of operations in hryvnia.

In recognition of Ukraine’s great potential as an agricultural producer, the EBRD supports investments along the whole value chain and especially instruments that benefit primary producers. The Bank has been actively supporting policy dialogue in grain, dairy and meat sectors. Improvement of market information systems and establishment of sectoral working groups as platforms for public-private consultations were important for promoting greater transparency and predictability of policy interventions. In order to bolster investments in the Agribusiness sector, the Bank provided significant support for the development and introduction of reforms aimed at streamlining regulations. Significant capacity development efforts have been deployed by the Bank to promote dissemination of best international practices, to improve access to new markets for local producers and to stimulate innovation for better sectors efficiency.

The Bank continues to pursue its strategic goal of supporting sustainable development in respect of environment, natural resources and energy. Together with other IFIs, the EBRD continues to explore mechanisms for supporting the authorities as they pursue modernization of the Ukraine’s gas transit system and implementation of the March 2009 EU-Ukraine memorandum of understanding, which is the cornerstone of EU-Ukraine cooperation in the field of energy. In particular, the Bank is assisting with the modernization and rehabilitation of the main trans-European energy networks of Ukraine and investments in modern and energy efficient generation, transportation and distribution of energy. These aims are complemented by a support to reforms in the energy sector to advance its liberalization and promote private sector involvement. The Bank together with the EU, the World Bank, the IMF and the EIB has been actively engaged in joint policy dialogue with the Ukrainian authorities for a number of years with the aim to provide technical and financial assistance to reform and restructure the gas sector and to modernize the gas infrastructure based on market-based principles and liberalization. The key transition objectives of the joint IFIs action plan in the energy sector can be grouped into three themes: (i) restructuring of Naftogaz (NAK) according to EC Directive 2003/55/EC, including through the Corporate Governance Action Plan which envisions putting in place a board of directors with majority independent directors, unbundling of the gas sector/NAK by implementing effective separation of transmission activities from the operations not related to transmission and ensuring the independence of the gas transmission network operator; (ii) adoption of EU-based liberalization legislation as per Energy Community Treaty requirements; (iii) establishment of a credible independent regulator focused on the long-term development of the network and integration with larger, more liquid gas markets.

In addition, the Bank is actively supporting diversification of supply sources and promoting alternative fuels and development of renewable energy sector in Ukraine. The Bank signed two private deals (solar and hydro) for the total amount of €23 million over 2015–16. In natural resources, the Bank extended a three-year $300 million revolving working capital facility to NAK, a 100 percent state-owned gas holding, to finance the company's gas purchases via Ukraine's interconnections with the EU. The facility was built on several gas sector reform conditionalities, including the requirement to develop and implement a far-reaching Corporate Governance Action Plan for NAK agreed with the government.

In 2016, the EBRD launched a new program for financing energy efficiency in the residential sector ('IQ Energy') for up to €90 million, including €15 million from E5P for investments. It is currently available to the EBRD partner banks UkrSibbank (BNP) and OTP for lending to private sector sub-borrowers (individuals and HoAs) for energy efficiency investments in the residential buildings.

Finance and Technology Transfer Centre for Climate Change (FINTECC) was launched in 2016 to facilitate deployment of climate-friendly technologies through a combination of policy dialogue, technical assistance and incentive grants. A total $7 million is available from the GEF for incentive grants, which is expected to leverage about $40 million in investments into the best available climate technologies and techniques in Ukraine.

In the area of nuclear safety, the Bank is working to improve the safety standards at the existing nuclear power plants and in 2013 signed a €300 million Nuclear Safety sovereign loan with Energoatom (the operator of the Ukrainian nuclear power plants) as part of a major €1.4 billion project to be co-financed by the Bank, Euroatom and Energoatom. Main part of the EBRD and Euroatom financing is used to procure safety equipment for installation on the existing nuclear power plants. The Bank has administered two international special funds for: (i) ensuring the safe decommissioning of the Chernobyl NPP; and (ii) construction of a New Safe Confinement over the destroyed Unit 4 of the Chernobyl NPP and its old Shelter. A major milestone was achieved in November 2016, when the New Safe Confinement was successfully put in place over the Unit 4.

In 2016, the Bank signed four municipal sector loans for a total amount of €41 million. Two loans to public transport companies in the cities of Kremenchuk and Ivano-Frankivsk were committed for renewal of the aged trolleybus fleet and development of municipal public transport infrastructure. The loans are co-financed by investment grants from the E5P Fund (€2 million for Kremenchuk) and the Bank's shareholders' fund (€1 million for Ivano-Frankivsk). Lviv wastewater biogas project is one of the first large scale biogas projects in Ukraine based on municipal wastewater facilities. The project is co-financed by a loan from NEFCO, an investment grant from the E5P Fund and a charter fund contribution from the City of Lviv. The total amount of co-financing is €16.5 million. Another project will finance capital expenditures related to the implementation of the automated fare collection system in Lviv on a design, build and maintain basis. Municipal guarantees were extended in support of all these loans. The Bank's pipeline of municipal projects is strong and includes projects in the areas of municipal public transport and energy efficiency for public buildings, although regulatory constraints and shortcomings in the tariff policy delay their materialization. The Bank is also considering projects related to district heating, water and wastewater, street lighting and municipal solid waste management.

In transport, the Bank continued to promote commercialization and reform of the major transport operators though loan conditionalities and policy dialogue which, among other things, contributed to corporatisation of Ukrainian railways. To address critical bottlenecks, the Bank continued to finance the rehabilitation of the main pan-European road corridors, modernization of the national air navigation system as well as construction of a new railway tunnel. Preparation has been underway for new railway infrastructure and rolling stock projects. In addition, the Bank provided support to independent private companies working in the area of agricultural logistics to finance new port terminals and associated infrastructure critical for improving efficiency and expanding national export capacity.

Under the Reform Support Architecture for Ukraine, the Bank in collaboration with the EU is providing support to public administration to rebuild the reform momentum and establish a sustainable approach to reforms. The EBRD is supporting activities that range from reform conceptualization to implementation assistance. As part of this framework, Reform Support Teams (RSTs) will be established in selected ministries. RSTs will be tasked with the implementation of priority reforms undertaken by these ministries, and with the transformation of public administration within these ministries. A high-level international Strategic Advisory Group for Support of Ukrainian Reforms (SAGSUR) was established to provide expert advice to the prime minister and the president.

STATISTICAL ISSUES

(December 2016)

I. Assessment of Data Adequacy for Surveillance
General. Data provision has some shortcomings, but is broadly adequate for surveillance. Among Ukraine's economic and financial data, there are some shortcomings, particularly in national accounts, government finance statistics (GFS), and external sector statistics.
National Accounts. The National Accounts (NA) are compiled in accordance with the 2008 SNA. Volume measures are annually chain linked and compiled using 2010 as the benchmark year. Quarterly GDP is compiled by Production, Expenditure and Income at current and previous years' prices.

Price statistics. The weights of the consumer price index (CPI) are updated annually and the compilation methods are in line with international best practices. The coverage should be extended to include the cost of owner occupied housing. The State Statistics Service of Ukraine (SSSU) compiles a series of producer price indexes (PPIs), separately covering: mining, manufacturing and quarrying; construction; agriculture; and selected service industries. The SSSU launched two quarterly Residential Property Price Indexes (RPPIs), covering new and secondhand multiunit dwellings in April 2016. The indexes are based on a survey of real estate developers and agents, rather than comprehensive administrative data, and therefore suffer from a number of deficiencies. Starting in 2016, Ukraine is one of the beneficiaries of the SECO2 RPPI project, which will run until April 2019, to support the compilation and dissemination of RPPIs in line with the guidelines and best practices outlined in the *Handbook on Residential Property Price Indices*.
Government finance statistics. Compilers are cognizant of the *GFSM 2001/2014* methodology and reference materials. However, the lack of a strong legal framework for compiling GFS and its incomplete statistical coverage are significant shortcomings. The authorities plan on improving the data by fully implementing the GFSM 2001 framework when implementing the *Accounting System Modernization Strategy in General Government for 2007–2015*, which will include the introduction of a common chart of accounts for all government units that is harmonized with budget classifications and based on GFS. A lack of clarity on the stock of VAT refund claims prevents a full assessment of the underlying fiscal performance.
Monetary and financial statistics (MFS). Monthly monetary statistics are compiled and reported to the Fund by the NBU, based on standardized report forms (SRF) for the central bank (SRF 1SR) and for other depository corporations (SRF 2SR), since September 2006. In addition, the NBU reports monetary data covering Other Financial Corporations (OFCs, or nonbank financial institutions) on a quarterly basis since December 2008. Data for OFCs include several methodological departures from the IMF's MFS manual and compilation guide, concerning valuation and classification of financial assets. These departures were documented by a multisector diagnostic mission that visited the NBU in September 2015, which set out a work plan to improve the MFS.
Financial sector surveillance. The NBU reports Financial Soundness Indicators (FSIs) to STA and EUR on a regular quarterly basis since end-2005. FSIs reported include all FSIs for deposit takers and two FSIs for real estate markets.
External Sector. The compilation system relies heavily on the International Transactions Reporting System, customs declaration database, and enterprise surveys, providing a broad coverage of data on a timely basis. Nevertheless, direct data collection through enterprise surveys and a more intensive use of available data sources would improve data quality in the areas of financial services, travel, compensation of employees, workers' remittances, and reinvested earnings. Goods statistics could benefit by improving the methodology for estimating the c.i.f./f.o.b. conversion coefficient as well as by bringing reporting forms and instructions in line

with the international guidelines. Efforts are also needed to reconcile direct investment data provided by the survey enterprises and ITRS, and to determine the sources of large FX cash held outside of the banking system classified under currency and deposits. In line with 2012 STA TA, improvements are needed regarding direct investment by improving the coverage of debt instruments data and the valuation of equity. STA is currently seeking Dutch funding for a TA project, which is aiming at enhancing the external sector statistics (ESS) over the period 2017–19. Key areas to be covered under the project are (i) improvement of the source data on direct investment (DI), including by supporting steps for transferring data collection responsibilities from the State Statistical Service of Ukraine to NBU and conducting an improved DI survey and moving towards more comprehensive source data on services through survey-based data collections in line with regional (European Union) practices; and (ii) enhancing consistency and coverage of balance of payments and IIP indicators, in particular with regard to the financial flows and stocks.	
II. Data Standards and Quality	
Participant in the SDDS since January 10, 2003.	Data ROSC published on August 19, 2003.
III. Reporting to STA	
The country’s IFS page has been published since July 1996. Annual government finance statistics have been reported for 1999–2015. On monetary statistics, data have been published since September 2006 using the SRF framework in the *IFS* and are available online. The authorities also report regularly the quarterly data on Financial Soundness Indicators. These data are disseminated on the IMF’s website with observations beginning in 2005. Data on international investment position has been compiled and reported since 2002.	

Ukraine: Table of Common Indicators Required for Surveillance
(January 23, 2017)

	Date of latest observation	Date received	Frequency of data[6]	Frequency of reporting[6]	Frequency of publication[6]	Memo Items: Data Quality—Methodological soundness[7]	Memo Items: Data Quality—Accuracy and reliability[8]
Exchange Rates	11/30/2016	12/08/2016	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	10/31/2016	11/21/2016	M	M	M		
Reserve/Base Money	9/30/2016	10/21/2016	D	D	M	O, LO, O, O	O, O, O, O, NA
Broad Money	9/30/2016	10/21/2016	D	D	M		
Central Bank Balance Sheet	9/30/2016	10/21/2016	M	M	M		
Consolidated Balance Sheet of the Banking System	9/30/2016	10/21/2016	M	M	M		
Interest Rates[2]	10/31/2016	11/18/2016	D	D	M		
Consumer Price Index	9/30/2016	10/28/2016	M	M	M	O, LO, O, O	O, O, LO, O, O
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	Q3/2016	6/2016	M	M	M	O, LO, LO, O	O, O, O, O, NA
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government	11/2016	12/2016	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Q3/2016	12/2016	M	M	M		
External Current Account Balance	Q3 2016	12/19/2016	M	M	M	O, LO, LO, O	LO, O, O, O, LO
Exports and Imports of Goods and Services	9/30/2016	10/28/2016	M	M	M		
GDP/GNP	Q3 2016	12/2016	Q	Q	Q	O, LO, O, O	O, LO, O, O, LO
Gross External Debt	Q3/2016	12/2016	Q	Q	Q		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

[2] Both market based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); or Not Available (NA).

[7] Reflects the assessment provided in the data ROSC published in August 2003 and based on the findings of the mission that took place in April 2002 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning (respectively) concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

[8] Same as footnote 7, except referring to international standards concerning (respectively) source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.

Statement by Vladyslav Rashkovan, Alternate Executive Director for Ukraine
April 3, 2017

On behalf of the Ukrainian authorities I would like to thank staff for the in-depth report and productive discussions during and after the last mission in Kyiv, as well as for the continuous helpful technical assistance.

My authorities are in a broad agreement with the well-balanced staff's assessment of the economic situation and outlook and the key policy recommendations, which will be carefully considered in addressing the challenges to the Ukrainian economy. The authorities reaffirm their strong commitment to the policies and objectives under the IMF program.

I will focus the comments on (1) economic developments and outlook, (2) monetary policy, (3) financial sector policy outcomes and plans, (4) fiscal policies and pension reform agenda, (5) structural reforms to improve the business climate, including the anticorruption progress.

Macroeconomic stabilization remains on track, over performing in many areas

The authorities broadly share staff's analysis of the economic developments and outlook. The commitment to the adopted flexible exchange rate, fiscal consolidation, strict income policies, raising energy tariffs and reforms of the public procurement system led to a sharp reduction of Ukraine's twin deficit.

As a result, the economy moved out of the deep recession. Real GDP growth accelerated to 4.7 percent yoy in Q4 2016, bringing the total tally for 2016 to about 2.2 percent. Economic growth outperformed expectations, mainly on account of a record high agricultural harvest which also became an important source of export proceeds. On the expenditure side, real GDP growth was underpinned by a strong rebound of investment and rebuilding of inventories. Private consumption, despite signs of recovery, remained subdued amid mixed labor market performance and stalled lending activity. Thus, labor demand has been improving, underpinning a 9 percent growth in real wages following two years of deep decline.

The current account balance improved noticeably compared to pre-crisis levels. However, robust investment demand and continuing export difficulties caused the current account deficit to widen to US$3.4 billion, or 3.6 percent of estimated GDP in 2016. Net financial inflows stood at a strong US$4.6 billion in 2016 given a substantial decline in foreign cash outside banks and a slowdown of private sector debt outflows.

As a result of the policies, all continuous and end-December 2016 performance criteria were met. The recent stabilization provides a good base for achieving faster economic growth, subject to the completion of the ongoing structural reforms, the success of which is crucial for restoring the business environment, elevating the private and foreign investments and increasing the labor productivity.

Nevertheless, the recovery remained slow and fragile. Disruption of economic links between different regions of Ukraine due to the continuing military conflict in the east as well as Russia's trade and transit restrictions, exerted a toll on the pace of recovery. In January and February 2017, some factories decreased or even stopped entirely the volume of metallurgy production due to the military attacks in Avdiyivka.

On March 15, 2017 the National Security and Defense Council of Ukraine decided to temporarily halt cargo movements, both by roads and railways, between unoccupied and occupied territories in Ukraine. The decision was a reaction to the seizure of Ukrainian enterprises located in the occupied territories, many of which re-registered with the territory controlled by the Ukrainian authorities and operating fully in accordance with Ukrainian legislation. The cargo transportation will remain suspended until seized enterprises are returned. In case this issue is not resolved soon, it is expected to have a significant adverse impact on exports and growth this year.

Monetary policy in the course of 2016 was tight and will remain appropriately tight in 2017

Inflation has been successfully brought down from 61 percent in April 2015 to 12.4 percent by end-2016, mostly thanks to moderate aggregated demand, prudent monetary and fiscal policy, stabilization on the foreign exchange market, and a number of supply-side factors. Inflation is expected to remain in double digits through the most of 2017 given an ongoing utility tariff adjustment and return to single digit in Q4 2017.

The National Bank of Ukraine's (NBU) officially announced the adoption of an inflation targeting regime and successfully met the inflation target for 2016. This was the result of significant progress with implementing a forward-looking and transparent monetary policy, which the NBU achieved in course of the program. Important steps are made by the NBU in areas such as: enhancing analytical potential for supporting medium-term monetary policy decisions making; strengthening the NBU communications with the market, increasing transparency and accountability for its monetary policy decisions. The NBU welcomes further technical assistance from the IMF focused on strengthening inflation targeting framework.

The new NBU Council approved the monetary policy guidelines for 2017 with the inflation target of 8 percent by end 2017 (± 2 percent) and for the medium term. In line with this and following the disinflation trend, the key policy rate was gradually decreasing in the course of 2016, and was always kept positive in real terms. Further gradual easing of the monetary policy will depend on the inflation expectations and reserves accumulation.

Gross international reserves have increased above US$15 billion and the NBU met the September and December 2016 net international reserves targets, while the nominal exchange rate has stabilized with an average rate of 25.5 in 2016, slightly higher than at the time of the second review. The NBU will continue gradually relaxing foreign exchange restrictions and administrative controls, which became barriers for attracting new foreign direct investments in Ukraine. The priority will be given to measures that help improve business conditions and deepen the foreign exchange market.

The conditionality of the program is modified in line with the evolution of the monetary regime in Ukraine. The authorities' intention to include in the program an indicative target for inflation and to remove the indicative target for base money was supported by the latest IMF mission. As the next step, the authorities aim to change the conditionality of the program to the Inflation Consultation Clause in order to reflect the progress with the implementation of inflation targeting.

The NBU's impressive progress with containing inflation and rebuilding reserve buffers would not be feasible without the NBU having a clear policy mandate and operational independence. It is important that its new strong institutional framework be preserved and protected.

The efforts of cleaning up the banking sector bring the first sustainable results

More than 90 weak insolvent banks have been resolved and left the banking market in the period 2014–17. Owing to the efforts of the NBU, the ownership in the banking sector became transparent: 100 percent of remaining banks disclosed their ultimate beneficiary owners (UBO), which also supported the NBU initiatives over the decrease in sizable connected lending.

While finalizing the balance cleanup from distressed assets, banks increased provisioning in the second half of 2016. The diagnostics of connected lending have also been recently completed. Therefore, by end-2017 the NBU will have accomplished the most extensive and detailed asset quality review of the Ukrainian banking sector. It lays the foundation for development of a well-capitalized and liquid sector efficient in financial intermediation.

Although many challenges for the financial sector remain, they are under control: plans for recapitalization and for unwinding related-party exposures have been approved for the majority of banks, the largest private bank PrivatBank has been nationalized and capitalized.

In the course of the nationalization the authorities bailed in the related parties deposits equal to about 1¼ percent of GDP, while the overall capital shortfall of the bank due to related parties lending was nearly 7 percent of GDP. A reputable audit firm was hired to perform a due diligence of the bank, and a forensic audit will be conducted to help investigate possible wrongdoing ahead of the bank's nationalization. An international asset management firm will be hired to collect the related parties loan portfolio. After PrivatBank's nationalization, state banks dominate with their combined market share by assets exceeding 50 percent. The authorities intend to accelerate the reform of state banks, introduce new corporate governance and risk management standards and develop efficient business model.

As a result of the NBU policies, confidence has been gradually restored. Real household net disposable income began to grow for the first time in three years. Thanks to the return of households' deposits and inflows of corporate funds, banks' funding base is on the rise, while funding costs go down. The NBU expects deposits to grow faster in 2017 compared to 2016, and the banking sector in general to start making profits again in 2017 after three years of heavy losses.

Restart of lending is the key task for the banking sector in 2017, while it will primarily depend on the recovery of corporate solvency and on progress with enhancing the protection of creditors' rights. Further delays with making necessary legal amendments and judicial reform would cause material losses for the economy through underinvestment, underutilized output capacities, and under-received personal incomes and budget revenues.

Fiscal consolidation brings sustainability to the public finances

Budget execution continued to be strong due to stronger revenues, overperforming of the program targets, with 2016 budget deficit limited to 2.3 percent of GDP compared to a target of 3.7 percent of GDP. As one of the prior actions for the completion of the third program review, the parliament timely approved a 2017 government budget consistent with the deficit target of 3.1 percent of GDP.

An automatic tariff adjustment mechanism has been put in place, adjusting gas tariffs semi-annually to ensure that they remain at import parity. To facilitate the liberalization of tariffs utility subsidies will be monetized, while control of the subsidies will be tightened and more targeted to keep them fiscally affordable while at the same time protecting the poorest households from the higher energy tariffs and incentivizing energy efficiency.

The authorities successfully completed the restructuring of nearly all external liabilities included in the perimeter of the debt operation in line with the financing and debt objectives of the program. Public debt is still above the safe levels, but the projections suggest that debt will fall below 70 percent of GDP by 2021, subject to continuing macro stabilization and economic growth. The authorities remain committed to reach an agreement on the restructuring of the Russian-held bond in line with program parameters and will continue efforts to reach an agreement consistent with the IMF policies. Further structural fiscal reform is critical to achieve the fiscal targets, both in dealing with the large size of the informal economy and meeting the medium-term fiscal sustainability.

The authorities also started working on improving revenue administration and strengthening the institutional framework of the State Fiscal Service (SFS), transforming it to the modern service organization to effectively collect and enforce taxes. Further stronger oversight by the

Ministry of Finance (MoF) of SFS will be built. Parliament is expected to adopt legislation about a new civil service responsible for investigation of financial offences to replace the current tax police and to consolidate responsibilities of fighting financial offenses against the state into a single agency, while avoiding duplication of functions.

The Ukrainian population is rapidly aging and the pension fund has a structural deficit that needs to be addressed. Structural problems in the labor market (low compliance of social security contributions and low participation rates), unfavorable demographics, and outdated pension rules have eroded the sustainability of the pension system. Following the reduction of privileged pensions, the authorities plan to implement further comprehensive pension reform to help offset adverse demographic trends. The key targets of this reform will be to put the pension system on a sustainable basis, provide incentives for workers to contribute, and ensure adequate pensions over time. The total saving effect of the reform is estimated to be at least 3 percent of GDP over the long term.

Fiscal policy in 2017 and beyond will be anchored by the medium-term consolidation plan reflected in the IMF-supported program.

Achieving macro and financial stability—momentum for structural reforms to be used to improve the business climate

The authorities agree with staff that the progress with advancing the structural reforms has been mixed and share the view that the strength and durability of the recovery depends on the pace and depth of the structural reforms in the coming years. This is the reason why the authorities remain strongly committed to pursue the structural reforms aimed at improving the business environment, overcoming the difficulties which sometimes arise from passing the legislation approval in the parliament.

Following the approved strategy, the authorities intend to accelerate the reform of state-owned enterprises (SOE). The authorities agree that a set of larger companies will need to be privatized in a transparent process in parallel with much faster divesture of smaller companies which should be facilitated by launching an electronic platform. So far this reform has failed to generate momentum, but there is a plan in action to improve the legal framework for the privatization, including the delayed adoption of the amendments to the respective law to improve the transparency and safeguards.

Adopting the legislation to allow the sale of agricultural land and lifting the moratorium on land sales is one of the important steps planned to be executed in 2017, which will unlock Ukraine's growth potential. Despite the difficult political landscape, the authorities are committed to pass the respective legislation in the parliament to allow the sale of land under adequate safeguards.

To ensure that prosecution of acts of corruption by senior officials receives a specialized and prioritized judicial response, the authorities will operationalize the anticorruption court—the respective legislation to be adopted by parliament in June 2017. This legislation will include provisions to ensure budgetary autonomy and adequate security of the anticorruption judiciary framework and establish the selection process for anticorruption judges.

The authorities request a rephasing of pending structural benchmarks, taking into account structural reform priorities and the authorities' observed implementation capacity, and propose new structural benchmarks. In light of the delay with the completion of this review, the authorities request a reduction in the number of reviews to 10 and a rephasing of the remaining access to align purchases with reform progress and balance of payments needs.

Concluding remarks

The Ukrainian economy is recovering: GDP is growing, inflation has declined, official reserves have more than doubled, the financial system is getting stronger, the current account deficit and fiscal deficit fell sharply. Flexible exchange rate and correct fiscal policies have greatly reduced internal and external imbalances.

The authorities remain strongly committed to continue with the program implementation and are determined to fulfill all obligations under the economic program supported by an IMF arrangement under the Extended Fund Facility to achieve the program's long-term goals. Their next focus will be directed to the pension reform, land reform, privatization, continuing fighting corruption, by, amongst other measures, setting up the anticorruption court, further strengthening of the public institutions, including comprehensive transformation of the State Fiscal Service.

The authorities are grateful for the cooperation and support from the IMF, other IFIs and the international community.