IMF Country Report No. 19/3

UKRAINE

January 2019

REQUEST FOR STAND-BY ARRANGEMENT AND CANCELLATION OF ARRANGEMENT UNDER THE EXTENDED FUND FACILITY—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR UKRAINE

In the context of the Request for Stand-By Arrangement and Cancellation of Arrangement Under the Extended Fund Facility, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board following consideration at the Staff Report by the Executive Board on December 18, 2018.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on December 18, 2018, following discussions that ended on November 9, 2018, with the officials of Ukraine on economic developments and policies underpinning the Stand-By Arrangement. Based on information available at the time of these discussions, the staff report was completed on December 7, 2018.
- A **Staff Supplement** updating information on recent developments.
- A **Statement by the Executive Director** for Ukraine.

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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International Monetary Fund
Washington, D.C.

Press Release No. 18/843
FOR IMMEDIATE RELEASE
December 18, 2018

International Monetary Fund
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Washington, D. C. 20431 USA

IMF Executive Board Approves 14-month US$3.9 Billion Stand-By Arrangement for Ukraine, US$1.4 Billion for Immediate Disbursement

The Executive Board of the International Monetary Fund (IMF) today approved a 14-month Stand-By Arrangement (SBA) for Ukraine. The arrangement amounts to the equivalent of SDR 2.8 billion (about US$3.9 billion, 139 percent of quota). The Board also took note of Ukraine's decision to cancel the arrangement under the Extended Fund Facility for Ukraine that was approved on March 11, 2015 (see Press Release No. 15/107).

The authorities' economic program supported by the SBA will build on the progress made under the EFF arrangement. The SBA will provide an anchor for the authorities' economic policies during 2019 and focus on maintaining macro-economic and financial stability. The program will focus on four priorities: (i) continuing the ongoing fiscal consolidation to keep public debt on a downward path; (ii) further reducing inflation, while maintaining a flexible exchange rate regime; (iii) strengthening the financial sector, promoting asset recovery, and reviving bank lending; and (iv) advancing a focused set of structural reforms, particularly to improve tax administration, privatization and governance.

The approval of the SBA enables the immediate disbursement of SDR 1 billion (about US$1.4 billion). The remainder will be available upon completion of semi-annual reviews.

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

"The Ukrainian authorities have successfully restored macro-economic stability and growth, with support from the international community. Prudent fiscal and monetary policies and a flexible exchange rate regime have helped reduce fiscal and current account deficits. Reserves have been partly rebuilt and confidence has improved.

"A new Stand-By Arrangement will provide an anchor for the authorities' economic policies during the coming year, preserving recent economic gains and paving the way for higher sustainable growth. Together with support from the World Bank and the European Union, the arrangement will help Ukraine meet its financing needs.

"The authorities' program focuses on maintaining macro-economic stability, notably through continued fiscal consolidation and inflation reduction. This will be accompanied by targeted reforms to strengthen tax administration, governance, and the financial and energy sectors, while continuing to provide social assistance for the most vulnerable.

"The authorities remain committed to fiscal discipline to place public debt firmly on a downward path. It will be important to resist pressures to increase spending or lower taxes, while renewing efforts to improve public financial management and revenue administration.

"Monetary policy aims to reduce inflation and rebuild international reserves within a flexible exchange rate regime. Safeguarding central bank independence will be crucial in this regard. Efforts are underway to address nonperforming loans, recover assets from failed banks, and improve governance in state-owned banks.

"Further progress on anti-corruption reforms and privatization will help attract investment and improve the business climate more broadly. Priorities include operationalizing the anti-corruption court, privatizing large state-owned enterprises, streamlining regulations, and advancing land reform.

"Program implementation is subject to significant risks, both domestic and external. The authorities have taken important steps to mitigate these risks, including by adopting a sound 2019 budget, raising gas and heating tariffs, and adopting legislation to improve governance in state-owned banks. The full and timely implementation of the program will be critical for its success in light of the difficult challenges."

Ukraine: Selected Economic Indicators, 2014–18

	2016	2017	2018 Proj.	2019 Proj.	2020 Proj.
Real economy (percent change, unless otherwise indicated)					
Nominal GDP (billions of Ukrainian hryvnias)	2,385	2,983	3,447	3,916	4,433
Real GDP 1/	2.4	2.5	3.3	2.7	3.0
Contributions to real GDP growth					
Domestic demand	7.1	7.1	5.4	4.6	4.9
Net exports	-4.6	-4.7	-2.2	-1.9	-1.9
GDP deflator	17.1	22.0	11.9	10.6	9.9
Consumer prices (period average)	13.9	14.4	11.0	9.2	5.9
Nominal monthly wages (average)	23.3	37.1	23.0	17.2	11.0
Unemployment rate (ILO definition; percent)	9.3	9.5	9.2	8.6	8.0
Public finance (percent of GDP)					
General government balance 2/	-2.2	-2.2	-2.5	-2.3	-2.3
Public and publicly guaranteed debt	81.2	71.9	65.2	64.3	59.8
Money and credit (end of period, percent change)					
Broad money	10.9	9.6	9.8	8.7	13.8
Credit to nongovernment	-1.1	2.1	8.4	3.2	11.2
Interbank o/n rate (annual average, percent)	16.9	11.9	16.6	…	…
Balance of payments (percent of GDP)					
Current account balance	-1.5	-2.2	-3.3	-2.9	-2.2
Foreign direct investment	3.5	2.3	1.7	1.6	1.7
Total external debt	122.5	104.1	95.5	92.3	86.7
Gross reserves (end of period, billions of US$)	15.8	18.8	18.8	19.5	20.9
Months of next year's imports of goods and services	3.0	3.3	3.2	3.1	3.2
Percent of IMF composite metric (float)	55.5	65.0	66.3	66.5	69.6
Exchange Rate					
Hryvnia per U.S. dollar (end of period)	27.2	28.1	…	…	…
Real effective rate (deflator-based, percent change)	0.5	11.6	…	…	…

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.

INTERNATIONAL MONETARY FUND

UKRAINE

December 7, 2018

REQUEST FOR STAND-BY ARRANGEMENT AND CANCELLATION OF ARRANGEMENT UNDER THE EXTENDED FUND FACILITY

EXECUTIVE SUMMARY

Context. The Ukrainian authorities have been able to restore macro-economic stability and growth following the severe economic crisis of 2014–15. However, efforts to create a more dynamic, open, and competitive economy have fallen short of expectations, and the economy still faces important challenges. Investment, particularly foreign direct investment, is held back by a difficult business environment, while large numbers of worker seek job opportunities abroad as economic growth is too low for incomes to noticeably close the gap with regional peers. Reserves have recovered, but remain relatively low, while the economy is still vulnerable to shocks.

Request for a new Stand-By Arrangement (SBA). The authorities request a new 14-month SBA in the amount of SDR 2.8 billion (about $3.9 billion, 139 percent of quota) to help meet Ukraine's balance of payments needs. The SBA will succeed the arrangement under the Extended Fund Facility (EFF), which will be cancelled. The authorities believe that a new program can play a crucial role in anchoring policies during the upcoming election period (presidential and parliamentary elections are scheduled for March and October 2019, respectively) and until a new government is formed by end-2019. The program will aim to preserve recent economic gains and maintain reserves against an unsettled external environment, building on the progress made under the EFF arrangement.

Program design. Policies under the program will focus primarily on: (i) continuing the ongoing fiscal consolidation to keep public debt on a downward path; (ii) further reducing inflation, while maintaining a flexible exchange rate regime; (iii) strengthening the banking system, promoting asset recovery, and reviving bank lending; and (iv) advancing a focused set of structural reforms, particularly to improve tax administration and governance.

Risks. Risks to the new program are high, notably due to the unresolved conflict in the eastern part of Ukraine and the unsettled external environment, as well as pressures for populist policies or policy reversals ahead of the upcoming elections. These risks are mitigated by strong frontloaded actions, including approval of the 2019 budget, and significant external financing to support reforms. This includes new financing from the World Bank and the European Union. Nonetheless, the authorities' steadfast policy implementation will be critical for the program to succeed.

Approved By
Thanos Arvanitis (EUR) and Mark Flanagan (SPR)

Discussions were held in Kyiv during September 6–19, 2018. The staff team comprised Ron van Rooden (head), Pamela Madrid, Gabor Pula, Sergio Sola (all EUR); Luis Cortavarria-Checkley, Ivan Oliveira Lima, Mesmin Koulet-Vickot, Tjoervi Olafsson (MCM); Serhan Cevik (FAD); Belen Sbrancia (SPR); Emmanuel Mathias, Maksym Markevych (LEG); and Gösta Ljungman, Wim Fonteyne, Ihor Shpak, Mariia Sydorovych, Mariia Chebanova (Resident Representative office). Thanos Arvanitis (Deputy Director EUR), Ceda Ogada (Deputy Director LEG) and Vladyslav Rashkovan (OED) participated in some of the discussions. A small team comprising Ron van Rooden (head), Gabor Pula, and Sergio Sola (all EUR) visited Kyiv during November 5–9, 2018 for follow-up discussions. Chasta Piatakovas and Samuel Romero Martinez (EUR) provided support from headquarters.

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INTRODUCTION

1. **The Ukrainian authorities have been able to restore macro-economic stability and growth following the severe economic crisis of 2014-15, with strong support also from the international community**. The economy was hit hard by the conflict in the eastern part of the country and the ensuing disruption in trade and production and loss of confidence. In the midst of a deep recession and a sharp exchange rate depreciation, banks came under severe strains, public debt moved to an unsustainable path, and international reserves dropped to critically low levels. Much has been achieved since then, owing to the authorities' efforts, supported by an arrangement under the Extended Fund Facility (EFF) approved in 2015 (see Box 1), including prudent fiscal and monetary policies and a shift to a flexible exchange rate regime, which sharply reduced fiscal and current account deficits. Reserves have been partly rebuilt and confidence has strengthened.

2. **However, with some notable exceptions, efforts to create a more dynamic, open, and competitive economy have fallen short of expectations.** Beyond macro stabilization, the EFF arrangement was also designed to help Ukraine transform its economy—a key objective of the authorities after the Maydan revolution. Despite some initial success in advancing energy and banking sector reforms, and setting up anticorruption institutions, reforms increasingly faced resistance (e.g., anticorruption efforts, restructuring and privatization of state-owned enterprises (SOEs), land reform), causing delays in the completion of reviews. Only three reviews were completed under the EFF arrangement, instead of the originally planned 15. With the EFF arrangement set to expire in March 2019, insufficient time remained to fulfill the objectives of the arrangement.

3. **The economy continues to face important challenges**. Growth is still too low to recover the incomes lost during the crisis and for incomes to catch up to levels seen in regional peers. The business environment is still weak, discouraging investment, the banking system has yet to address the burden of legacy non-performing loans (NPLs), and external financing conditions have become tighter and more volatile. Importantly, disappointed with domestic economic conditions, outward migration has increased significantly, with an estimated 2–3 million Ukrainians working abroad.

4. **Valuing the role of a Fund-supported program in anchoring economic policies, the authorities request a new Stand-By Arrangement (SBA) to succeed the EFF arrangement.** The authorities believe that a new program can play a crucial role in anchoring policies during the upcoming election period and until a new government is expected to be formed by end-2019 (presidential elections will be held in March 2019 and parliamentary elections in October 2019), by preserving recent economic gains against an unsettled external environment**.** A new program would help cover Ukraine's balance of payments needs by bolstering confidence and unlocking external financing and supporting the needed adjustment. The program will focus primarily on maintaining economic and financial stability and advancing reforms that are within the authorities' capacity. The authorities have already implemented some key actions to set the program off to a good start, including adopting a sound 2019 budget, raising gas and heating tariffs, and adopting legislation to improve governance in state-owned banks.

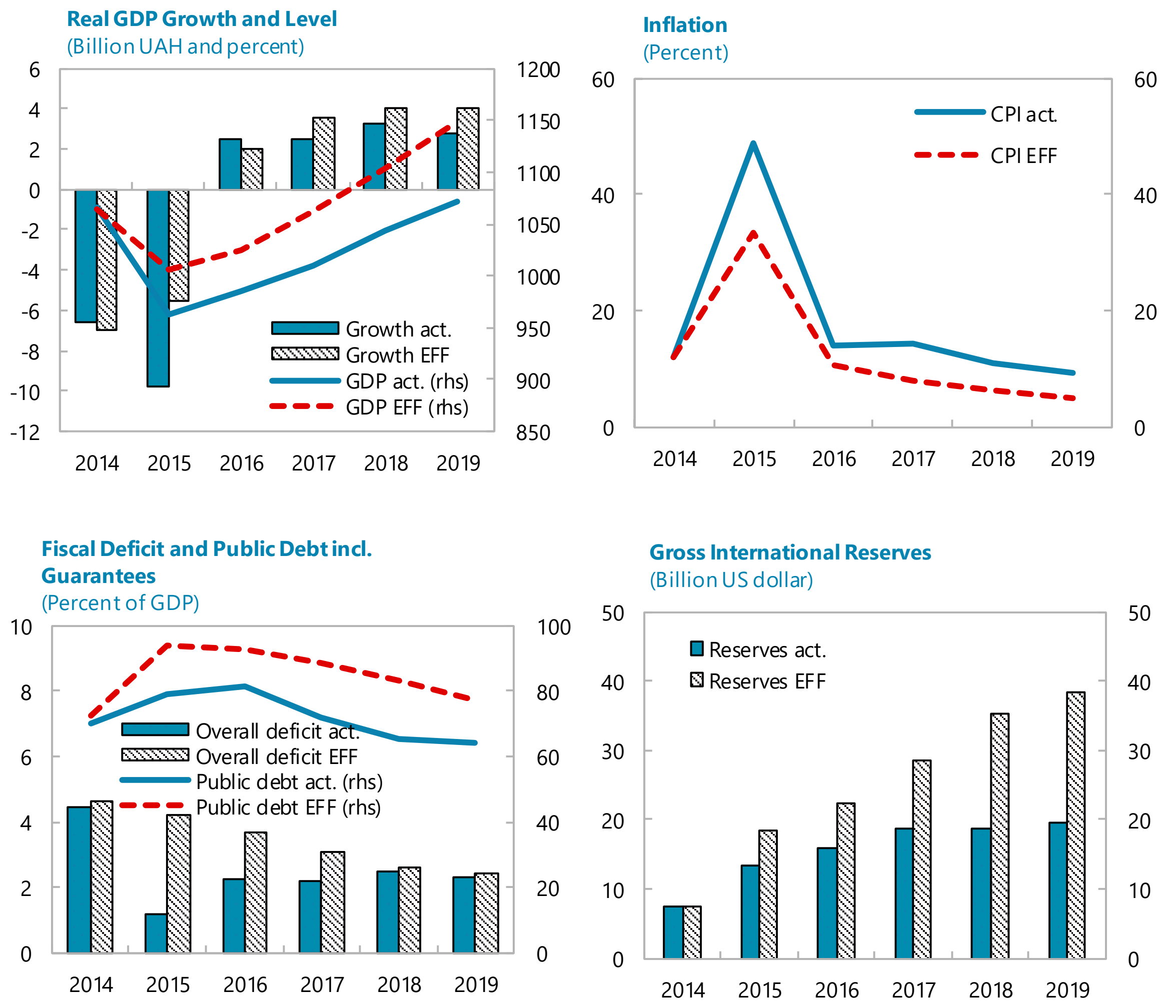
Box 1. Progress Under the EFF Arrangement

Prudent economic policies resulted in a dramatic reduction in the country's external and internal imbalances and a return to economic growth. Notably, the adoption of a flexible exchange rate regime, strict income policies, and an impressive fiscal consolidation led to a sharp reduction in Ukraine's twin deficits. The current account deficit fell sharply from over 9 percent of GDP in 2013 to 2 percent of GDP in 2017. The overall fiscal deficit—including the energy sector's quasi-fiscal deficit—which had swelled to 10 percent of GDP in 2014, declined to just above 2 percent of GDP in 2017, supported by bold increases in energy tariffs in 2015 and 2016. Notwithstanding a deeper recession in 2015, as the conflict in the east took a larger than expected toll on economic activity, with stronger policies confidence was gradually restored and the economy started to grow again in 2016. On the back of strong fiscal discipline and tight monetary policies, a more stable economic environment, as well as a debt operation with private creditors, public debt declined from its peak of 85 percent of GDP in 2014 to below 70 percent by the end of 2018. However, international reserves remained significantly below projections, reflecting slower than expected official disbursements, while inflation has been above targets.

These broadly positive results mask some continuing deep underlying challenges. After initial progress, delays in reform implementation led to frequent program interruptions. While the first review under the EFF was completed broadly on time, the second review was delayed by 9 months, mainly related to a drawn-out approval process of the 2016 budget, political tensions culminating in a change in government in April 2016, and delays in appointing NABU management. The third review was completed two years after the program started, following delays in adopting an automatic gas tariff adjustment mechanism, resolving a systemically large but insolvent bank, and implementing asset declaration requirements for high-level officials. Programs of other institutions suffered from similar delays in the implementation of policy commitments.

Overall, progress in structural reforms has been uneven. Initially, impressive progress was made in strengthening the independence and governance of the NBU and cleaning up the banking system, with many insolvent banks resolved and weaker, but solvent, banks recapitalized. In the energy sector, gas and heating tariffs were brought closer to market levels with bold increases in 2015 and 2016—also reducing opportunities for corruption—but soon after, the authorities suspended the implementation of the automatic formula once international prices started to rise again, opening a gap with import-parity prices, despite a generous utility subsidy system that supports vulnerable households. Progress on structural fiscal reforms was more contentious, with the authorities favoring deep tax cuts, while delaying the implementation of pension reform until the fall of 2017 and revenue administration reform has yet to start in earnest. Following pressure from civil society and with international support, new independent institutions were set up to tackle corruption, with the establishment of the National Anticorruption Bureau of Ukraine (NABU) and a Special Anticorruption Prosecutor's Office (SAPO), and recently the approval of legislation to set up an anticorruption court. However, no cases of high-level corruption have so far been adjudicated, deepening the public perception that not much has effectively changed. Also, although a new legal framework was adopted to facilitate privatization and numerous regulations were streamlined, ensuring property rights and the rule of law, improving the business environment, and the restructuring of the large and inefficient public sector—including through privatization—have remained incomplete. Importantly, the opening up of markets, including by creating a competitive gas market and a market for agricultural land, have also yet to happen.

Box 1. Progress Under the EFF Arrangement (concluded)



Sources: Ukrainian authorities, IMF staff calculations.

PROGRAM OBJECTIVES AND FINANCING

5. **The authorities request a new 14-month SBA in the amount of SDR 2.8 billion (about US$3.9 billion, 139 percent of quota) to succeed the EFF arrangement, which will be cancelled.** Policies under the program will focus primarily on maintaining economic and financial stability. Specifically, policies will aim at: (i) continuing the ongoing fiscal consolidation to keep public debt on a steady downward path; (ii) further reducing inflation to within the central bank's 5±1 percent target range, while maintaining a flexible exchange rate regime; (iii) strengthening the banking system, promoting asset recovery, and reviving bank lending; and (iv) advancing a limited set of structural reforms, particularly to improve tax administration and governance. The attached Letter of Intent (LOI) and Memorandum of Economic and Financial Policies (MEFP) set out the authorities' detailed policy commitments.

6. With the policy mix committed under the SBA and prospective financing, including from other IFIs and capital markets, Ukraine should be able to meet its sizable financing needs. Access, both in terms of annual purchases and outstanding credit, would remain below exceptional access thresholds, and would help to maintain reserves at a level equivalent to three months of imports. Despite sizable foreign exchange purchases by the National Bank of Ukraine (NBU) so far in 2018 and targeted also for 2019, reserves will remain well below the level equivalent to 100 percent of the composite metric that had been targeted under the EFF arrangement, also impacting the pace of the removal of remaining restrictions and capital flow measures (see paragraphs 24 and 43). Firm financing commitments are in place for the duration of the arrangement to support the authorities' reform efforts. This includes the European Union's new Macro Financial Assistance program (€1 billion) and a new World Bank Policy-Based Guarantee that will enable the authorities to raise US$1 billion. Strong program implementation will also help unlock additional capital market financing in 2019. Despite the increased volatility in financial markets, Ukraine recently raised US$2 billion in capital market financing.

Ukraine: Program Financing
(US$ billion)

	2015	2016	2017	2018	2019
Financing Gap	18.6	6.3	6.2	4.0	4.1
Reserve accumulation	5.8	2.5	3.0	0.0	0.7
Underlying BOP gap	12.8	3.7	3.2	4.0	3.5
Financing	18.6	6.3	6.2	4.0	4.1
IMF	6.5	1.0	1.0	1.4	2.5
Other multilateral/bilateral	3.3	1.8	0.8	0.6	1.6
Multilateral 1/	1.0	0.4	0.2	0.0	1.0
European Union	0.9	0.1	0.6	0.6	0.6
Other bilateral	1.4	1.3	…	…	…
Debt operation	5.7	3.5	4.4	2.0	…
Other expectional financing	3.1	…	…	…	…
Memorandum Items					
Capital market access	0.0	0.0	3.2	2.7	2.0
Gross international reserves	13.3	15.8	18.8	18.8	19.5
% of composite metric	51.3	55.5	65.0	66.3	66.5

1/ The World Bank will provide a guarantee (PBG) of USD750mn in 2019.

7. The authorities are committed to continuing efforts to resolve the outstanding official arrears consistent with the requirements of the policy on lending into arrears to official bilateral creditors. A lawsuit filed by Russia in the UK courts is ongoing.[1] Staff's assessment is that the Ukrainian authorities have continued to pursue good-faith efforts. In terms of process, they have offered to meet with the Russian authorities in the context of a substantive dialogue to reach an out-of-court agreement on the restructuring of the US$3 billion bond. The terms offered by the Ukrainian authorities are in line with the financing and debt objectives set at the time of the restructuring, which are an important assumption underpinning the present program. The terms offered to Russia are proportionate to the contributions made by other official bilateral creditors at the time of the restructuring. Furthermore, for the reasons outlined in Box 4 of IMF Country Report No.16/319, a decision to provide financing despite the arrears is not expected to have an undue

[1] In February 2016, the Trustee of the Eurobond held by Russia's National Wealth Fund brought summary proceedings in the UK's High Court of Justice seeking full payment of principal and interest. On March 29, 2017, the High Court ruled in favor of Russia but stayed execution of the judgement pending consideration of Ukraine's appeal. On September 14, 2018, the UK Court of Appeal reversed the High Court's summary judgement, returning the case to the High Court for full trial. The Russian authorities have indicated their intention to appeal the decision to the Supreme Court. If they do so, the Supreme Court will need to decide whether to accept the case, in which case hearings would likely be held next year. If the decision is not appealed, or if the appeal is rejected, the case will be returned to the High Court for a full trial.

negative effect on the Fund's ability to mobilize official financing packages in future cases. 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 reforms to support its economy and address balance of payments needs. Thus, in staff's view, the conditions have been met for the Fund to proceed with providing financial support to Ukraine.

8. The program's success hinges crucially on three key assumptions: (i) the full and timely implementation of policies under the program; (ii) timely external financing from the official sector and continued capital market access; and (iii) the non-intensification of the conflict in the eastern part of Ukraine. These assumptions are incorporated in, and are critical for, the program.

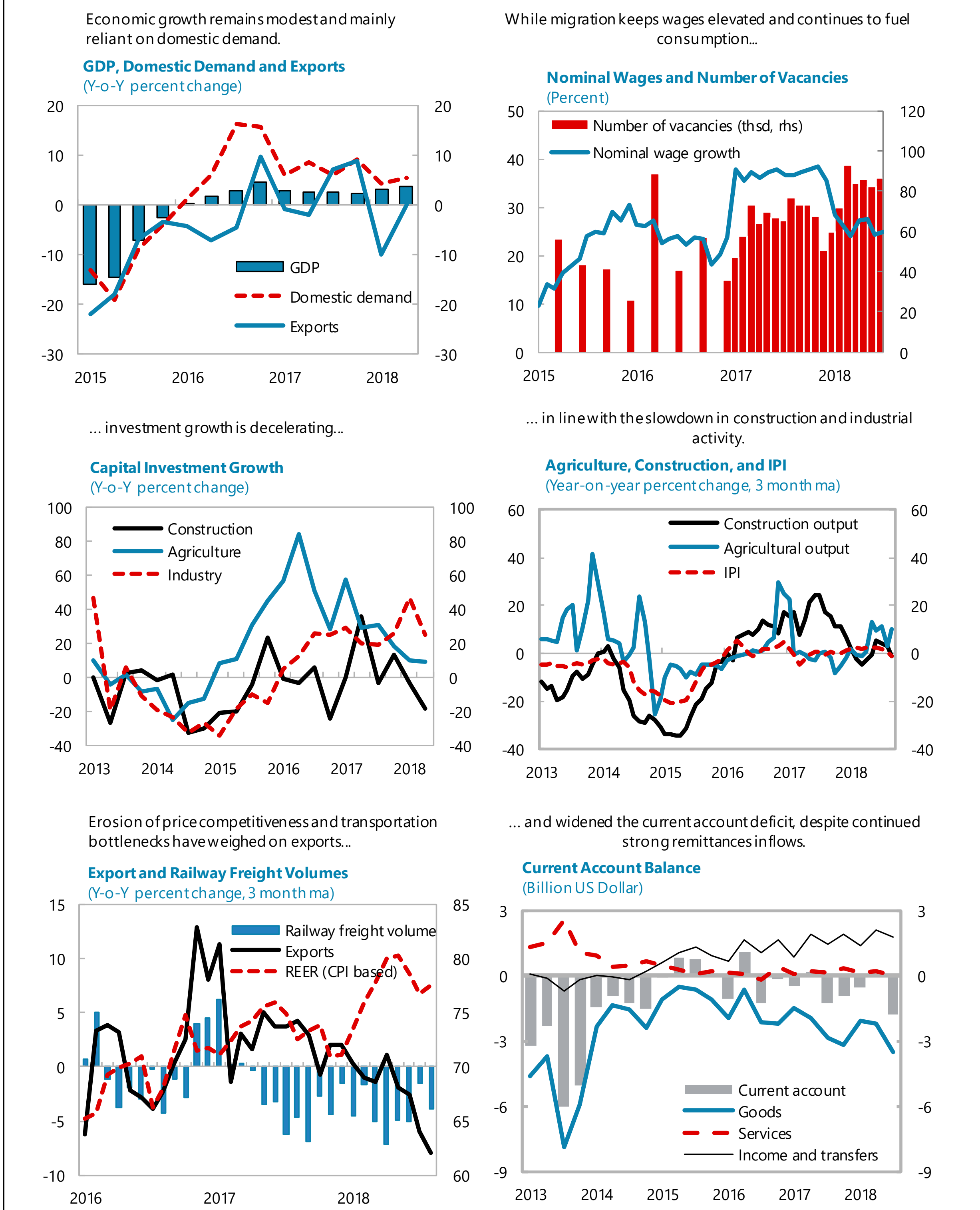
MACROECONOMIC OUTLOOK AND RISKS

9. The current economic recovery is expected to continue. Growth reached 2.5 percent in 2017 and is expected to reach 3.3 percent this year, on the back of strong domestic demand. The latter, together with some moderate real exchange rate appreciation, also contributed to a pick-up in imports and a widening of the current account deficit to 3.3 percent of GDP this year. Reacting to the sharp hike in policy rates, inflation has been slowly declining this year, after having peaked at 16.5 percent in September 2017 following large wage and pension increases and food price shocks. Inflation is expected to reach 10 percent by the end of 2018, due *inter alia* to higher energy prices (including higher gas and heating tariffs) (Tables 1–6).

10. In the absence of substantial reforms, growth is expected to remain constrained to about 3 percent annually. Growth is projected to slow slightly, to 2.7 percent in 2019, as worsening terms of trade and rising production cost—notably wages—are expected to trim economic activity and offset somewhat the impact of the still robust domestic demand. At the same time, slow progress in reforms and political uncertainty will continue to weigh on investment. Without an acceleration in reform implementation in the coming years, potential growth will remain low and growth will remain below the growth rates forecast for most CESEE countries. Growth will be far from enough to enable people's living standards to catch up with income levels in regional peers; per capita GDP (at PPP) in Ukraine, although improving, will remain among the lowest in Europe.

11. Inflation is expected to continue its downward path in 2019. Although inflation expectations remain elevated, continued tight monetary policies and slowing domestic demand will help to gradually bring inflation back to just under 7 percent by end 2019 and within the NBU's target range of 5±1 percent in early 2020.

Figure 1. Ukraine: Real Sector Indicators, 2013–18



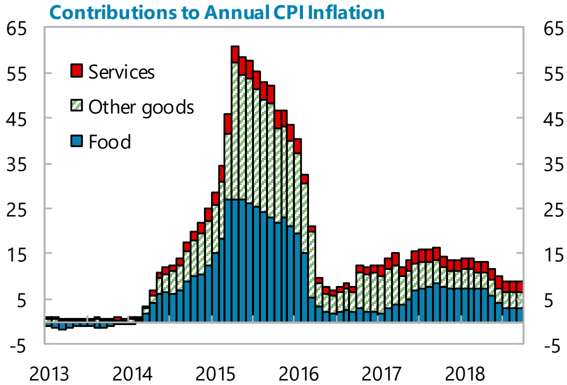
Sources: State Statistics Committee of Ukraine; Haver; and IMF staff calculations.

Figure 2. Ukraine: Inflation and Exchange Rate Developments, 2013–18

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

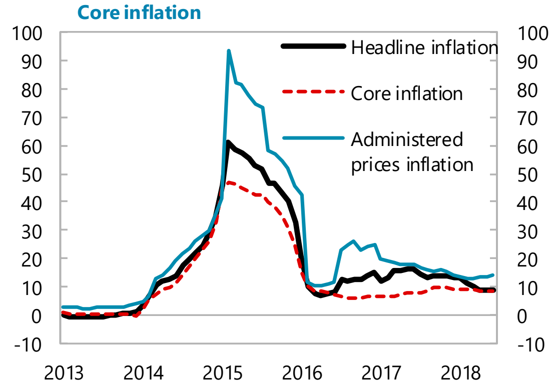
Headline inflation moderated recently due to a deceleration in raw food prices...

Contributions to Annual CPI Inflation



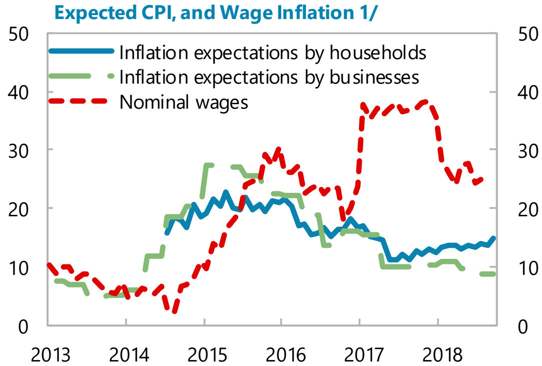
... but core inflation remained elevated at almost 10 percent...

Core inflation



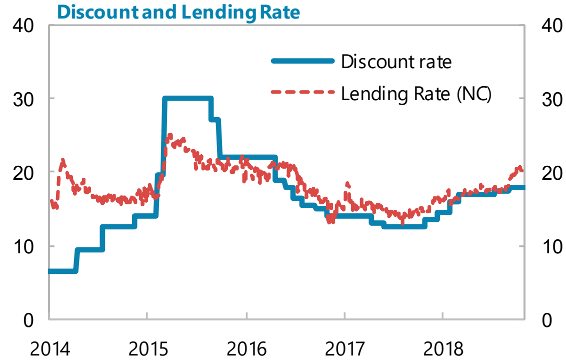
... driven by high nominal wage growth and still elevated inflation expectations.

Expected CPI, and Wage Inflation 1/



Given rising inflationary pressures due to strong domestic demand and increasing energy prices, the NBU raised its policy rate in several steps.

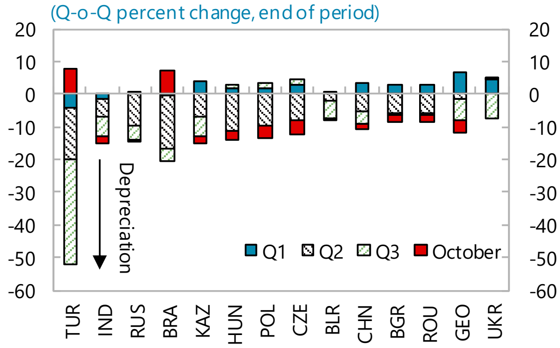
Discount and Lending Rate



The hryvnya / USD exchange rate has been relatively stable in 2018, despite tightening financial conditions for EMs.

Exchange Rates of Selected EM Currencies versus USD, 2018

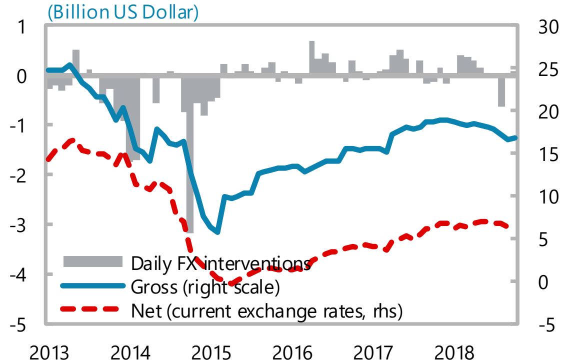
(Q-o-Q percent change, end of period)



Reserves are recovering as NBU purchases have continued in 2018, albeit at a lower pace.

International Reserves

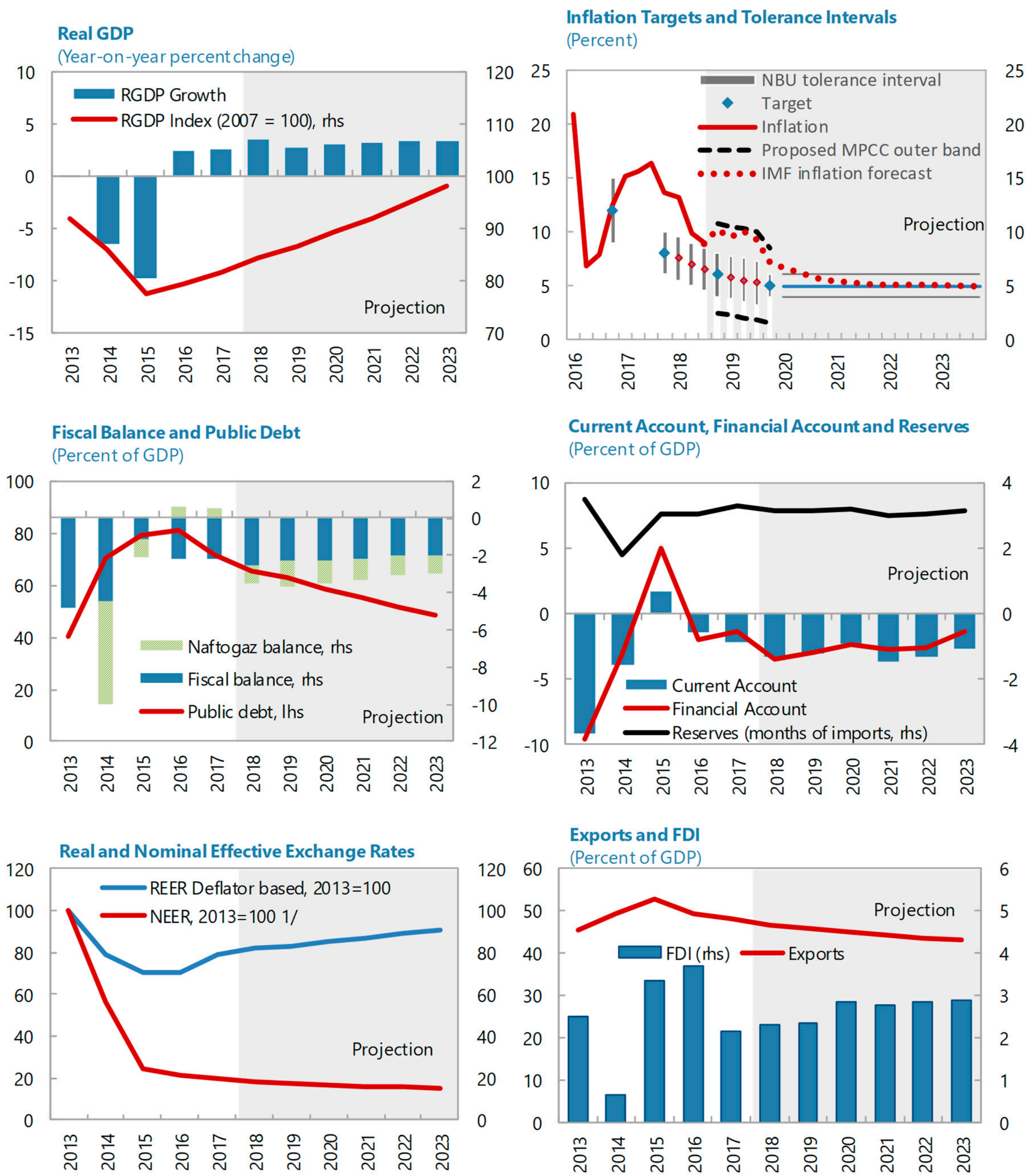
(Billion US Dollar)



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

1/ 12-months ahead inflation expectations. For businesses from Business Outlook Survey, conducted by the NBU. For households from GfK-Ukraine Consumer Confidence Survey.

Figure 3. Ukraine: Selected Economic Indicators, 2013–2023



Sources: Ukrainian authorities and IMF staff calculations.
1/ The nominal effective exchange rate is based on US dollar, Euro, and Russian Ruble.

12. Under the baseline, the current account deficit is projected to remain at around 3 percent of GDP in the coming years. Exports are expected to continue to increase, albeit at a somewhat decelerated pace (4–6 percent annual volume growth), relying primarily on exports of metals, mineral products, industrial goods, and agricultural products, and on the back of a real exchange rate that is broadly in line with fundamentals.[2] Imports are expected to continue to outpace exports as domestic demand remains strong. Gas transit revenues are expected to decline once the Nord Stream 2 pipeline is completed around 2020. Sizable remittances, together with official and capital market financing are projected to cover the trade deficit and increasing debt service obligations, while foreign direct investment is expected to remain relatively low. Reserves are projected to remain at three months of import coverage, or about 65-70 percent of the composite metric. Reserves could reach higher levels after the election period should there be a renewed impetus for deep structural reforms that could lead to larger investment inflows and stronger growth, which would facilitate the faster elimination of the remaining restrictions and capital flow measures.

13. Downside risks, however, are very large. On the domestic side, this includes primarily the risk of policy slippages, as the pressure for populist policies could rise ahead of the elections. With increasing polarization in the run-up to the elections, the authorities' ability to implement the program could weaken. The conflict in the eastern part of the country remains a key vulnerability, as highlighted by recent events, although a ceasefire is generally holding. On the external side, risks include a possible further deterioration in Ukraine's terms of trade, a moderation in global and regional growth, and a worsening of market sentiment vis-à-vis emerging markets, which could make it difficult for Ukraine to tap international capital markets.

PROGRAM POLICIES

The program will maintain an appropriate policy mix, by maintaining a primary fiscal surplus—for debt sustainability purposes and to moderate absorption, in line with available external financing—combined with a continued tight monetary stance to bring inflation down and allow further reserve accumulation, while removing remaining exchange restrictions gradually as conditions permit.

A. Fiscal Policies: Continuing Consolidation to Bring Public Debt Down

14. The authorities have achieved a drastic fiscal consolidation. The budget deficit was reduced from 4.5 percent of GDP in 2014 to 2.2 percent of GDP in 2017—well below the program target of 3.1 percent of GDP on the back of a drastic reduction in spending, which more than offset some decline in revenue following the sharp reduction in the social security contribution rate in 2016. Adding the quasi-fiscal deficit of the national gas company, Naftogaz, the adjustment was even more impressive, with a reduction in the combined deficit from 10 percent of GDP in 2014 to

[2] EBA-lite estimates show that Ukraine's external position is broadly in line with fundamentals (see Annex 1). Although rising real wages have eroded some of the competitiveness gains since the sharp depreciation of the local currency in 2015, the real exchange rate remains broadly in line with fundamentals.

2 percent of GDP in 2017. As a result of these policies, public debt declined from its peak of 85 percent of GDP in 2014 to 72 percent at end-2017.

15. Fiscal discipline, however, started to weaken last year. Parliament approved a supplementary budget and pension legislation in the course of 2017 that included large wage and pension increases, which fed into higher spending in 2018. Together with additional spending on military pensions and utility subsidies, current spending is set to increase by almost 1 percentage point of GDP in 2018, and this year's budget deficit target of 2.5 percent of GDP is expected to be met only by curtailing capital spending.

16. To keep fiscal policy on track to achieve medium-term sustainability, parliament approved a 2019 budget with a deficit of 2.3 percent of GDP (*prior action*). With a primary surplus of 1½ percent of GDP, this is projected to bring public debt down to 64 percent of GDP by end-2019, placing it on a sustainable path (see the attached public debt sustainability analysis). The budget is based on conservative revenue assumptions and while defense spending continues to be elevated, the budget aims to improve the composition of spending by containing current spending. The deficit target is expected to be met thanks to a mixture of expenditure and revenue measures (MEFP ¶5b):

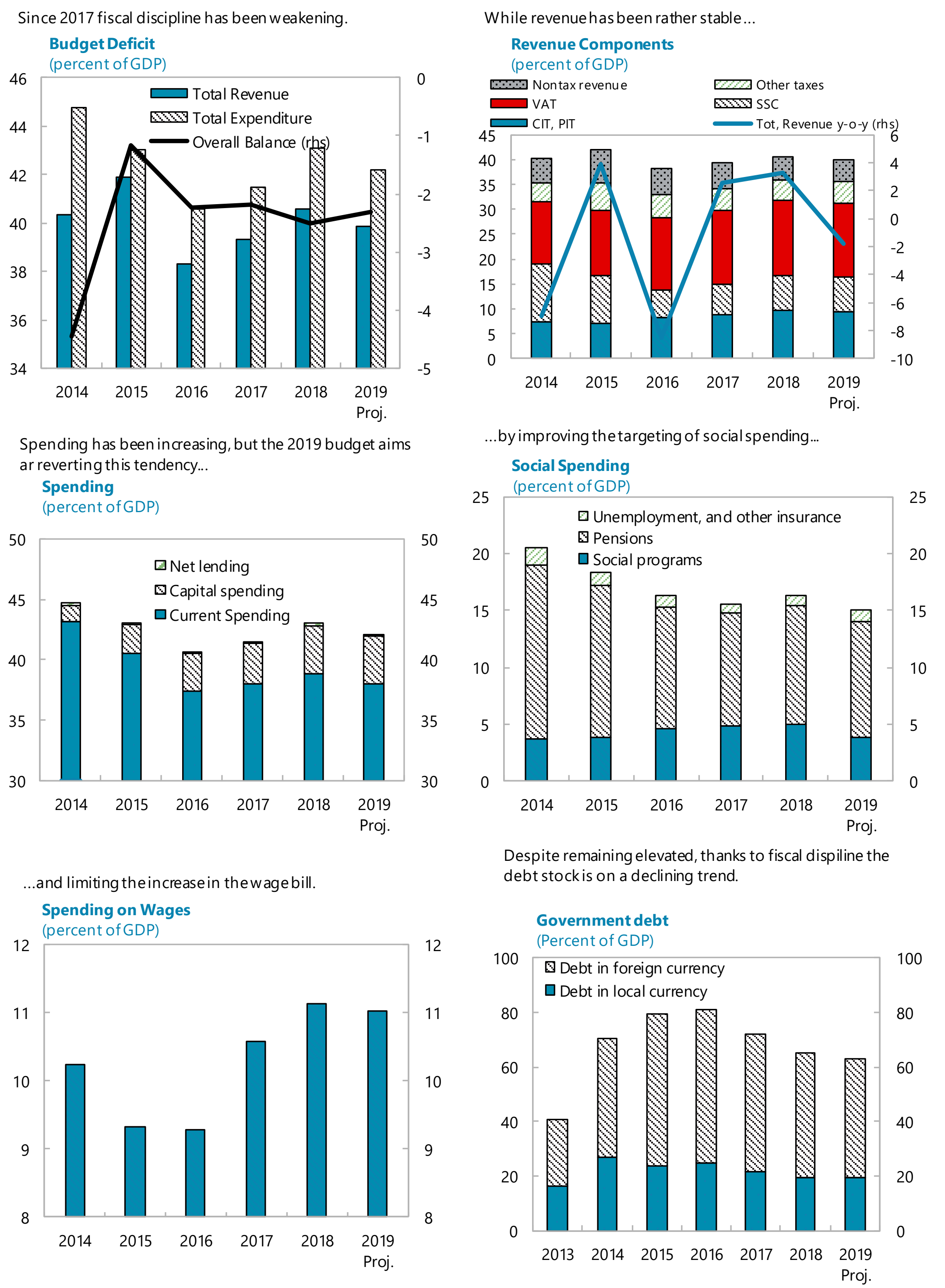
- ***Wage increases are contained*** to stabilize the wage bill as a share of GDP. The budget accommodates significant increases for military wages but includes limited increases for civil servants and public administration employees. To continue to reduce the incidence of poverty, the minimum wage is raised by 12 percent.

- ***Pensions will be raised in line with the indexation rules of the new pension law***, adopted in 2017 (see Box 2). Pension benefits will on average increase by 8½ percent, while retirees whose pensions equal the subsistence minimum will see a 9½ percent increase. With the implementation of the new pension law at the start of 2018, pension spending is projected to fall slightly in 2019, to just over 10 percent of GDP, while the pension fund deficit is projected to decline to 4¼ percent of GDP in 2019, compared to a deficit of over 6 percent of GDP in 2016.

- ***Sufficient social assistance is provided to vulnerable groups, including housing and utility subsidies (HUS), but with improved targeting.*** Utility subsidies will help defray the impact of higher gas and heating tariffs on low-income and vulnerable households, covering about 5 million households. In parallel, the authorities have enhanced means-testing of benefits to address issues that emerged with the increase in beneficiaries outside of the targeted groups last year, thus being able to contain budget outlays on HUS to 1½ percent of GDP.

- ***On the revenue side, the budget includes several tax measures.*** Besides increases in excise rates, the royalty rates for oil, gas condensate, iron ore and forestry usage and the environmental tax (on CO_2 emissions by stationary sources) are raised, while the increase in the wholesale price of gas for household use (see below) also leads to higher royalty and value-added tax payments. In addition, import duties are levied on used cars and the cap on wages subject to social security contributions will be lifted.

Figure 4. Ukraine: Fiscal Sector Indicators, 2014–18



Sources: National authorities; and IMF staff calculations.

(Percent of GDP)

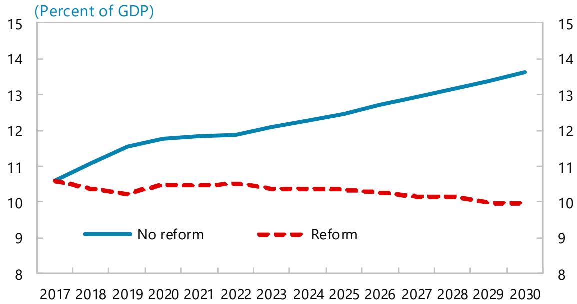
Box 2. Pension Reform

Pension reform in Ukraine was long overdue, and repeatedly delayed despite the critical need to place the pension system on a sound financial footing for future generations. Pension spending had reached over 11 percent of GDP in 2016, one of the highest levels in Europe, despite that average pension benefits were very low. This was the result of a very high dependency ratio, with about 12 million pensioners, representing almost 30 percent of the population, and an equal number of contributors to the pension system. On the other hand, pension fund revenues declined significantly following the halving of the social security contribution rate adopted in late 2015 raising the pension fund deficit to around 6 percent of GDP. The need for pension reform was further accentuated by unfavorable demographic trends, with low fertility and an ageing population, and a migration abroad of a growing number of workers.

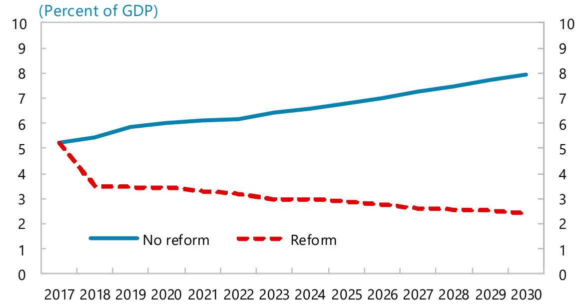
Parliament adopted a new pension law in October 2017, aimed at ensuring long-term sustainability and intergenerational equity. Key elements included a lengthening of the number of qualifying years needed to receive a pension and a strengthening of incentives to contribute. Individuals can retire within an age corridor of 60–65 years, depending on their years of service. Retiring at the earliest possible age of 60 will require at least 25 years of service in 2018 for both men and women (from 15 years previously), increasing by one year each year to 35 years by 2028. Retirement at the age of 63 will require 15 years of service in 2018, rising by one year each year to 25 years by 2028; and retirement at 65 will require a minimum of 15 years of service. A bonus of 6 percent for each year of delayed retirement (and 9 percent per year if the deferment is more than 5 years) provides an incentive to work longer. Options for early retirement have been substantially reduced. Pension benefits are indexed to a non-discretionary formula (which equals to 50 percent of consumer price inflation in the preceding year and 50 percent of the average salary growth rate in the preceding three years).

With these changes, pension expenditures are projected to stabilize at around 10 percent of GDP in the medium term, while social security contributions would grow steadily towards 8 percent of GDP. These trends would reduce the pension fund deficit by about 3 percentage points of GDP in the long run, from over 6 percent of GDP in 2016. Average replacement rates would improve but would still remain relatively modest at around 35 percent. Further improvement in pension benefit levels would require further parametric changes.

Pension Spending
(Percent of GDP)



Pension Fund Deficit
(Percent of GDP)



Source: IMF staff calculations.

17. Strong fiscal policies will need to be maintained in the coming years to continue the ongoing debt reduction. Beyond 2019, the authorities are committed to maintaining fiscal discipline, including by targeting primary surpluses between 1–1½ percent of GDP. There is a projected fiscal gap stemming from wage level objectives embedded in various pieces of reform legislation, including the civil service, health care, and education reform laws. There is scope under the legislation, however, to address this by limiting wage increases to inflation and productivity gains. Reducing public sector employment, and further improving tax administration and widening the tax base would give an alternative strategy to fully realize the objectives of these laws. It will be critical to avoid deficit-increasing tax changes. In this regard, the authorities have requested further technical assistance from the Fund to support their efforts.

18. After several false starts, the authorities are preparing to make a new push to modernize revenue administration (MEFP ¶7). As a priority, and to create a streamlined, function-based organization, they plan to consolidate current central and regional tax and customs units of the State Fiscal Service into two separate legal entities: a Tax Service and a Customs Service, by end-April 2019, which will both report to the Minister of Finance (a ***structural benchmark***). New management for both entities will be appointed through a transparent recruitment process, also by end-April 2019. The Ministry of Finance will strengthen its supervisory and control functions through detailed reporting requirements and key performance indicators, while the ministry will also complete an audit of the tax and customs administrations' IT systems to detect weaknesses and risks for data security. In parallel, the authorities are preparing additional operational steps to improve the efficiency of the tax and customs administrations and alleviate the compliance burden on taxpayers by shifting to risk-based audits; enhancing the online taxpayer portal (e-cabinet) to allow for online registration, updating of taxpayer information, and electronic payment; and improving taxpayer information services.

19. Efforts to further strengthen public financial management will also continue (MEFP ¶6). This includes the adoption of a medium-term budget framework (MTBF) for 2019–2021 to reinforce fiscal discipline, facilitate informed policymaking, and provide predictability in planning and executing budgets. The authorities will also seek to amend the budget code to reflect core elements of the MTBF, including a stronger mandate for fiscal risk monitoring and reporting; requiring a credit risk assessment for issuing government guarantees; introducing binding budget ceilings for key spending units in the annual budget declaration; and regularizing assessments of public expenditure efficiency through rolling spending reviews.

B. Energy Sector Policies: Strengthening the Gas Sector

20. Gas tariffs had not been adjusted since April 2016, despite rising international prices and the adoption in early 2017 of an automatic gas tariff adjustment mechanism as a prior action for the third review under the EFF. Fearing a political backlash, the authorities suspended the adjustment mechanism in the summer of 2017, leading to a growing wedge between household tariffs and the fully liberalized (import-parity) prices for industry. This re-created opportunities for corrupt schemes to divert household gas to industry. It also led to a worsening of Naftogaz' finances, although the company was able to maintain a positive cash balance owing to the receipt of sizable transit revenues.

21. As a first step toward the liberalization of gas tariffs, the government adopted a resolution (*prior action*) raising the wholesale price for gas for household use by 26 percent effective November 1, 2018, and by an additional 15 percent effective May 1, 2019 (MEFP ¶8a). As part of the prior action, new heating tariffs effective January 1, 2019 to reflect the higher wholesale price for gas have been approved and published by the energy regulator for the bulk of the heat supply companies. The tariffs for the remaining companies, which are set by local authorities, are expected to be approved before end-December 2018 (a ***structural benchmark***). Household gas tariffs will be fully market-determined as of January 1, 2020. The resolution also aims to improve the functioning of the gas market and payment discipline, including by allowing Naftogaz to bypass non-paying intermediaries and by creating a customer database, under the auspices of the Ministry of Finance, that will be available to all registered gas suppliers. A start will be made with the monetization of utility subsidies, with the assistance of the World Bank (MEFP ¶8b).

22. Further steps will also be taken to increase gas production and help ensure energy independence, via regular open tenders for production licenses and production sharing agreements (MEFP ¶8d). Preparations for the unbundling of Naftogaz will also continue, including the certification of a Transmission System Operator (MEFP ¶8c).

C. Monetary and Exchange Rate Policies: Reducing Inflation and Building Reserves

23. After an acceleration in 2017, inflation is declining and projected to end this year at around 10 percent. Headline inflation increased quickly in the second half on 2017, peaking at 16.5 percent in early 2018, following large wage increases in the public and private sectors. Although at around 10 percent at end-October 2018, headline inflation is still above the NBU's 6±2 percent target range, it has been on clear deceleration path in recent months, owing much to the NBU's commitment to its inflation targeting framework and decisive actions by raising the policy rate in six steps by 550 basis-points to 18 percent. Notwithstanding the turbulence in several emerging market countries, the hryvnia has remained relatively stable, allowing the NBU to buy on balance nearly US$1 billion so far this year—following net purchases of US$1.2 billion in 2017—and to continue to gradually ease administrative restrictions in line with the agreed roadmap under the EFF arrangement. Specifically, the NBU continued to expand the repatriation of dividends, canceled the daily limit on banks' net foreign exchange purchases and raised the limit on banks' open long foreign exchange position.

24. The NBU is strongly committed to continue with prudent monetary and exchange rate policies, to anchor inflation expectations and build stronger reserve buffers (MEFP ¶3). The monetary policy stance is appropriate, with the policy rate strongly positive in real terms, to bring inflation gradually down to within the NBU's inflation target by early 2020. As inflationary pressures ease, the policy rate can be gradually reduced, but should remain sufficiently high to enable the

NBU to steer inflation within the target band and to continue to buy foreign exchange, which is necessary to build stronger reserve buffers. This will also allow the NBU to continue with a gradual elimination of the remaining exchange restrictions, administrative controls, and capital flow measures in line with the agreed roadmap and the recently approved currency law that provides a new legal framework for currency operations. [3]

25. The NBU has continued to strengthen its monetary policy framework. With all its members now appointed, the NBU Council reaffirmed the NBU's commitment to inflation-targeting, with an inflation target of 5±1 percent for 2019 onwards, and a flexible exchange rate, with foreign exchange intervention aimed at rebuilding international reserves, smoothing exchange rate volatility, and supporting the transmission mechanism. The transparency and communication of monetary policy decisions have been enhanced with the release of the summary of the minutes of the Monetary Policy Committee meetings. To better align program conditionality with the NBU's inflation targeting regime and reflecting the strengthened institutional and technical capacity of the NBU, the program includes a monetary policy consultation clause. An indicative target on the NBU's net domestic assets is retained to safeguard against excessive expansion of the NBU's balance sheet.

26. The NBU is taking further steps to enhance its operational framework (MEFP ¶4). It will move to more active liquidity management, to better ensure that the interbank market rate remains close to the policy rate, especially as banks' overall liquidity position is expected to change from a structural surplus to fluctuating between a surplus and a deficit position. In this regard, enhancing liquidity forecasting, including by improving information sharing between the Ministry of Finance and the NBU will be important for effective monetary operations.

D. Financial Sector Policies: Strengthening Banks' Financial Health Further and Reviving Credit

27. Banks' financial health has continued to improve, although challenges remain. Capital buffers have strengthened since end-2016, with banks' core equity capital (CET1) ratio increasing by 2.2 percentage points to 11.2 percent by end-July 2018. All banks met the minimum regulatory capital of 7 percent of risk-weighted assets as of end-July 2018. Related-party exposures have substantially declined and following large provisioning and losses in recent years, the banking system is slowly returning to profitability. Liquidity ratios have also improved. Nonetheless, banks continue to grapple with a high level of NPLs, at over 55 percent of total loans (although these are largely provisioned for). Profitability remains a challenge for several banks.

28. The NBU reaffirmed its commitment to further strengthen bank capital. By end-March 2019, all banks should meet a minimum 7 percent Tier 1 capital and 10 percent CAR (MEFP ¶10). Banks that fail to meet these minimum capital requirements will face appropriate supervisory actions, including resolution, by end-June 2019 (a ***structural benchmark***). Additionally, to mitigate related-party exposure risks, the NBU agreed to revise by end-December 2018 the capital regulation

[3] See https://www.imf.org/external/np/g20/pdf/2018/092818.pdf.

to subtract from regulatory capital loan exposures to related parties that are above regulatory limits (a ***structural benchmark***).

29. The authorities will step up efforts to recover assets from failed banks and hold banks' former owners accountable as envisaged by the Banking law and the law on the Deposit Guarantee Fund (DGF) (MEFP ¶11). Progress in disposing of failed banks' assets by the DGF has so far been limited. The authorities reiterated their determination to accelerate the recovery and sale processes to reduce the cost of bank failures to the state, including via ongoing litigation. In addition, they are committed to seeking compensation from former bank owners and related parties, in line with provisions in the Banking and DGF laws. They will publish the list of all former shareholders of resolved banks that are yet to honor their debts to the failed institutions, as ruled by court decisions. In addition, they will publish regular progress reports on asset recovery and litigation efforts (a ***structural benchmark***).

30. Several initiatives are underway to facilitate NPL resolution (MEFP ¶12). Little progress has been made in reducing NPLs in the last two years, despite the adoption of a law to facilitate out-of-court restructuring and the removal of tax impediments to NPL resolution. In this regard, the authorities are taking further actions to encourage NPL workouts. In October 2018, a new insolvency law was approved by parliament. A policy framework for NPLs restructuring in state-owned banks is under preparation. In addition, the NBU, with technical support from the World Bank, is working on a regulation, in line with the European Central Bank (ECB) approach, to provide guidance to banks on how to reduce their NPL portfolios.

31. Improving governance in state-owned banks is a key priority (MEFP ¶13). State-owned banks now account for more than half of the banking system's assets. Following the recent adoption of a law to strengthen corporate governance in state-owned banks (a ***prior action***), the focus is now on establishing supervisory boards with a two-thirds majority of independent board members. The Ministry of Finance and each of the state-owned banks will also sign relationship agreements consistent with the updated Principles of State Banking Sector Strategic Reforms that will govern practical aspects of their interaction.

32. The authorities will further improve the supervisory and regulatory framework (MEFP ¶10d). Key actions include the adoption of a regulation on Tier 1 capital instruments in line with the Basel III criteria; the completion of the assessment of the collective suitability of the supervisory boards and qualifications of senior management; the verification of compliance with the risk management regulation; the adoption of the Supervisory Review and Evaluation Process (SREP), and the introduction of a new regulation on banks' registration and licensing, as well as a regulation on internal controls.

33. The authorities will also aim to secure parliamentary approval of legislation that is necessary for the development of financial markets (MEFP ¶14). Notably, they will encourage the adoption of the draft law to improve the financial supervisory architecture by end-March 2019 (a ***structural benchmark***). Additionally, they plan to submit a revised banking law to parliament by end-March 2019.

E. Structural Reforms: Improving Governance and Encouraging Investment

Governance

34. Although new institutions have been set up, the anti-corruption reforms have not yet delivered concrete results and continue to face strong opposition. While corruption investigations have intensified with the establishment of the National Anti-Corruption Bureau (NABU) and the Special Anti-Corruption Prosecutor's Office (SAPO), no high-level public official has been convicted of corruption. This could be attributable to significant vulnerabilities of the judicial system, still widely perceived as corrupt by the public. In addition, anti-corruption law enforcement agencies are under severe pressure. Attempts by vested interest to undermine the independence of NABU are increasing, while the credibility of SAPO has been damaged by recent missteps, including a disciplinary sanction against its head for misconduct.

35. The recent adoption of a legal framework enabling the High Anti-Corruption Court (HACC) is a welcome step forward. Following the enactment of the HACC law in the summer of 2018, the authorities are now working to ensure that the court can start its operations by end-June 2019 (MEFP ¶15a). To this end, the selection process of anti-corruption judges is ongoing and should be completed by end-April 2019 (a ***structural benchmark***), and it is of paramount importance for the credibility and reputation of the court that the judges to be selected have an impeccable reputation and relevant professional skills. It also remains important that the powers and independence of NABU are further strengthened, including by completing the independent external audit contemplated in the law by end-July 2019 (a ***structural benchmark***); by giving it the authority to wiretap independently; and by safeguarding its exclusive jurisdiction for high-level corruption cases (MEFP ¶15b).

36. Key additional actions, on asset declaration and AML/CFT, are necessary to consolidate and deepen anticorruption efforts (MEFP ¶15c and d). To unlock the potential of the asset declaration framework, the authorities should target compliance monitoring on high-level officials. This may be facilitated by transferring the responsibility for the verification of asset declarations of persons under NABU's jurisdiction to NABU. As the AML/CFT assessment of Ukraine published by Moneyval earlier this year concluded to an overall solid framework, this offers a good basis to continue leveraging AML/CFT measures to address corruption and the laundering of the proceeds of corruption. The legal framework preventing corrupt officials to misuse financial institutions needs to be fine-tuned and banks rigorously supervised, with the imposition of dissuasive sanctions for non-compliance. In this regard, the NBU's decision earlier this year to publish information on AML/CFT sanctions imposed on individual banks and their rationale has been a welcome step forward.

Privatization and Market Enhancement

37. While no major privatization has taken place in the last several years, a start has been made with selling selected state-owned enterprises (SOEs) (MEFP ¶16a). Following the approval of the new privatization law in February this year, the authorities hired reputable advisors for the privatization of six SOEs. A tender for the sale of power generation company Centrenergo will be launched by end-2018, followed by the six companies on the priority list by early-2019. Small-scale privatization, i.e. sales of assets under a UAH 250 million (about US$ 9 million), has been successfully launched in September 2018, with several small companies already sold. A draft law for establishing a transparent market for agricultural land has been prepared and the authorities will scale up technical preparations and outreach (MEFP ¶18) to boost public support for adoption of the law after the election season.

38. Governance of SOEs will continue to be improved (MEFP ¶16b). Following the appointment of new majority-independent supervisory boards at the state gas company Naftogaz, the railway company Ukrzaliznytsia and electricity company Ukrenergo, the process for the selection of independent supervisory boards for some of the other large SOEs, including Boryspil airport and Ukrposhta, is well underway. To clarify and strengthen the powers of these newly appointed supervisory boards and grant legal immunity and indemnity to its members, the authorities will seek parliamentary approval of the law on SOE governance. External audits of the largest SOEs will be conducted by reputable international companies.

39. Efforts are also made to better assess fiscal risks emanating from SOEs (MEFP ¶16c). A fiscal risks management division has already been established in the Ministry of Finance. Further steps will include the setting-up of a comprehensive fiscal risk management system and adopting the necessary legislative changes to better manage and reduce fiscal risks and enhance public asset and debt management (including public guarantees, public private partnerships, and local government borrowing).

40. In the last two years, the authorities have substantially streamlined the regulatory framework, *inter alia* by reviewing and abolishing non-relevant sub-legislative acts; streamlining procedures for obtaining permits and licenses; and improving clarity and transparency in the construction, telecom, and natural resource sectors. The authorities will continue to further review and streamline regulation (MEFP ¶17), in particular by reducing time required for land allocation, simplifying access to geological information, piloting online auctions for subsoil licenses, implementing risk-based approaches to audits and inspections by state authorities, simplifying cash registers usage by introducing new technologies and widening possibilities for cashless transactions, and imposing sanctions for violating cash turnover regulations.

PROGRAM MODALTIES

41. Phasing under the program is proposed to be spread over two semi-annual reviews. A first purchase of SDR 1.0 billion would be made available upon approval, followed by two purchases of SDR 0.9 billion each in the spring and fall of 2019, based on end-March 2019 and end-September 2019 performance criteria and a core set of structural benchmarks. The semi-annual review schedule will better fit the authorities' implementation capacity and the phasing of program measures, and thus the monitoring of progress toward program goals. An update safeguards assessment will need to be completed by the time of the first review. The NBU implemented all recommendations from the last assessment, conducted in April 2015.

42. Ukraine's capacity to repay the Fund remains adequate, although subject to considerable risks in the event of policy slippages and external shocks. While external debt service obligations are picking up to US$6–8 billion per year in the coming years, Ukraine is expected to be able to meet these provided that fiscal and monetary policies remain on track. With continued prudent policies, Ukraine is expected to continue to be able to access capital markets after the program, which would substantially ease debt servicing pressures. Thus, post-program financing needs would remain manageable, and the relative large repurchases in 2022 and 2023 could be supported if necessary by additional capital market borrowing. Risks to the Fund are large, however, particularly if policies deviate from the program, or if regional tensions were to intensify.

43. Ukraine continues to maintain exchange restrictions and Multiple Currency Practices (MCPs), but a roadmap is 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.

STAFF APPRAISAL

44. Ukraine has made impressive progress in reducing external and internal imbalances under the EFF arrangement in the last few years. The large fiscal and quasi-fiscal deficits have been reigned in and public debt is on a downward path; the exchange rate is broadly flexible; inflation, while still elevated, is declining; the central bank's international reserves have increased substantially; and, importantly, growth has returned. Several key reforms were also advanced, notably strengthening the independence and governance of the central bank, cleaning up the banking system, adopting pension reforms, raising gas tariffs, and setting up new, independent institutions to tackle corruption. This progress is commendable and was by no means assured when the EFF arrangement was approved in early 2015.

45. However, the slow progress in structural reforms is a missed opportunity to fundamentally transform the Ukrainian economy. The EFF arrangement offered an opportunity to begin to address some deep-rooted structural problems and create an enabling environment for private activity. Tackling corruption and entrenching the rule of law, reforming and privatizing the large and inefficient state enterprise sector and opening up the market for agricultural land and the gas sector were aimed at creating a more competitive and resilient economy, but these have yet to happen. Despite progress achieved, the structure of the economy remains largely unchanged, with key economic sectors still dominated by oligarchs, stifling competition and deterring new entrants. Also, while opportunities for corruption have been reduced, few of those who benefited from corrupt schemes have been convicted, leaving a sense of impunity and disappointment in society. As a result, investment remains low and far from enough to support the stronger growth needed for incomes to catch up with those in other countries in the region. It is regrettable, but not surprising, that an exodus of workers has taken place to find better job opportunities abroad.

46. Against the backdrop of continued balance of payments needs, there is merit in preserving the economic gains with a new Fund-supported program. Recent gains are not irreversible and can be lost in an election year if there is a backsliding of policies. It is reassuring that the authorities have developed a policy agenda that prioritizes macroeconomic stability on the basis of prudent policies, and value the continued engagement with the international community, including the Fund through a new SBA. It is important that the program stays on track throughout its duration and the authorities avoid missteps that led to delays and interruptions of previous Fund programs. It is equally important that commitments vis-a-vis other institutions are also carried out promptly to ensure their timely implementation.

47. The adoption of a sound government budget for 2019 shows the authorities' commitment to ensuring fiscal sustainability. Notwithstanding political pressures, there is no space for tax cuts next year, given the pressing spending needs and the imperative of continuing to reduce public debt. Instead, the authorities' effort should be squarely on improving tax and customs administration, which remains the Achilles heel of the current fiscal framework. Keeping the 2019 budget on target will strengthen confidence and help maintain Ukraine's access to capital markets. Efforts to recover losses to the state from bank failures need to continue unabatedly.

48. The transformation of the NBU into a modern central bank has been perhaps the most important recent institutional achievement and should be protected. Recent interest rate decisions are testament to the NBU's commitment to low and stable inflation as an anchor for economic stability. Its continuing efforts to improve banks' financial health, as well as its management of the foreign exchange system and the gradual removal of capital controls have been exemplary. It is crucial that the NBU's independence is safeguarded.

49. Firm implementation of the more narrowly focused set of reforms will be critical to the program's success. Strengthening revenue administration will be essential to help ensure fiscal sustainability, as well as to continue to improve governance and the business climate to attract investment and thus underpin growth and external sustainability, together also with continued efforts to tackle corruption and finally making a start with the sale of larger state-owned companies. Along with the operationalization of an independent anti-corruption court, it will be crucial for the effectiveness of the anti-corruption criminal justice framework that a credible anti-corruption prosecutor effectively supports the investigative efforts of NABU and ensures that robust cases related to high-level officials are prosecuted and sent for adjudication in an evenhanded manner. These are all areas where there is strong support within society, which should help overcome resistance from vested interests.

50. Staff supports the authorities' request for a Stand-By Arrangement, to succeed the EFF arrangement. The new SBA will provide an important anchor for the authorities' economic policies during a challenging year. The program has an appropriate balance between adjustment and financing, aiming to further reduce Ukraine's economic vulnerabilities. The risks to the new program—and to Ukraine's capacity to repay—are clearly large, especially the political risk and risk of policy slippages, as well as the risks from the unresolved conflict in the eastern part of the country. While these risks have been partly mitigated by the steps already taken by the authorities, steadfast implementation will be critical for the program's success. For these efforts, the authorities deserve the continued support of the international community. Staff also supports the authorities' request for approval, for a period of 12 months, of the retention of the exchange restrictions and multiple currency practices on the grounds that these are non-discriminatory, imposed for balance of payments reasons, and are temporary.

Table 1. Ukraine: Selected Economic and Social Indicators, 2017–2023

	2017	2018	2019	2020	2021	2022	2023
	Act.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Real economy (percent change, unless otherwise indicated)							
Nominal GDP (billions of Ukrainian hryvnias) 1/	2,983	3,447	3,916	4,433	4,918	5,420	5,970
Real GDP 1/	2.5	3.3	2.7	3.0	3.1	3.2	3.3
Contributions:							
Domestic demand	7.1	5.4	4.6	4.9	5.2	5.1	5.1
Private consumption	5.8	3.7	3.2	3.2	3.3	3.1	3.3
Public consumption	0.7	0.5	0.6	0.7	0.7	0.9	0.8
Investment	0.6	1.2	0.8	1.0	1.1	1.0	1.1
Net exports	-4.7	-2.2	-1.9	-1.9	-2.1	-1.9	-1.8
GDP deflator	22.0	11.9	10.6	9.9	7.6	6.8	6.6
Output gap (percent of potential GDP)	-1.7	-0.7	-0.4	-0.2	-0.1	0.0	0.0
Unemployment rate (ILO definition; percent)	9.5	9.2	8.6	8.0	7.3	6.8	6.6
Consumer prices (period average)	14.4	11.0	9.2	5.9	5.4	5.0	5.0
Consumer prices (end of period)	13.7	10.2	7.0	5.5	5.1	5.1	4.9
Nominal wages (average)	37.1	23.0	17.2	11.0	10.0	9.5	8.5
Real wages (average)	19.1	10.8	7.4	4.8	4.4	4.3	3.3
Savings (percent of GDP)	18.6	18.1	18.6	19.6	19.1	20.5	21.5
Private	17.4	16.9	17.1	18.0	17.4	18.5	19.6
Public	1.1	1.3	1.5	1.6	1.7	1.9	1.9
Investment (percent of GDP)	20.7	21.5	21.4	21.8	22.7	23.7	24.1
Private	17.4	17.5	17.3	17.5	18.3	19.4	19.8
Public	3.3	4.0	4.2	4.3	4.3	4.3	4.3
Public finance (percent of GDP)							
General government balance 2/	-2.2	-2.5	-2.3	-2.3	-2.2	-2.0	-2.0
Public and publicly-guaranteed debt	71.9	65.2	64.3	59.8	56.1	52.0	48.7
Money and credit (end of period, percent change)							
Base money	4.6	12.9	8.5	8.8	8.9	8.7	8.7
Broad money	9.6	9.8	8.7	13.8	13.7	13.5	13.1
At program exchange rate	9.4	9.7	7.1	14.2	14.2	15.7	14.1
Credit to nongovernment	2.1	8.4	3.2	11.2	10.9	10.7	10.8
At program exchange rate	4.2	5.5	0.1	10.4	10.7	13.9	12.5
Velocity	2.5	2.6	2.7	2.7	2.6	2.6	2.5
Interbank overnight rate (annual average, percent)	11.9	16.6	…	…	…	…	…
Balance of payments (percent of GDP)							
Current account balance	-2.2	-3.3	-2.9	-2.2	-3.6	-3.2	-2.6
Foreign direct investment	2.3	1.7	1.6	1.7	1.7	1.7	1.7
Gross reserves (end of period, billions of U.S. dollars)	18.8	18.8	19.5	20.9	20.8	22.9	23.5
Months of next year's imports of goods and services	3.3	3.2	3.1	3.2	3.0	3.1	3.2
Percent of short-term debt (remaining maturity)	41.1	53.1	50.4	54.0	50.0	50.4	51.4
Percent of the IMF composite metric (float)	65.0	66.3	66.5	69.6	66.4	69.2	68.8
Goods exports (annual volume change in percent)	7.8	3.9	4.7	3.9	4.6	5.6	6.2
Goods imports (annual volume change in percent)	16.7	7.3	4.5	5.1	6.9	7.0	6.9
Goods terms of trade (percent change)	6.8	-1.2	-1.7	3.1	1.4	1.5	1.7
Exchange rate							
Hryvnia per U.S. dollar (end of period)	28.1	…	…	…	…	…	…
Hryvnia per U.S. dollar (period average)	26.6	…	…	…	…	…	…
Real effective rate (deflator-based, percent change)	11.6	3.9	1.8	2.5	2.2	2.0	1.8
Real effective rate (deflator-based, 2010=100)	91.7	95.3	97.0	99.4	101.6	103.6	105.4
Memorandum items:							
Per capita GDP / Population (2017): US$2,640 / 44.8 million							
Literacy / Poverty rate (2016): 100 percent / 5.7 percent							

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

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, 2017–2023 1/

(Billions of Ukrainian hryvnia)

	2017	2018		2019		2020	2021	2022	2023
	Act.	Budget	Proj.	Budget	Proj.	Proj.	Proj.	Proj.	Proj.
Revenue	1,172.0	1,397.9	1,398.2	1,572.2	1,574.2	1,743.5	1,931.1	2,137.3	2,355.2
Tax revenue	1,019.8	1,236.8	1,236.6	1,390.8	1,392.9	1,570.1	1,741.2	1,930.1	2,129.1
Tax on income, profits, and capital gains	259.1	317.5	334.0	372.7	372.7	430.9	483.2	540.4	601.7
Personal income tax	185.7	226.7	230.2	267.4	267.5	311.8	351.1	394.7	441.1
Corporate profit tax	73.4	90.8	103.8	105.2	105.2	119.1	132.1	145.7	160.6
Social security contributions	185.6	247.3	237.0	265.8	265.5	309.4	346.9	393.0	436.5
Property tax	29.1	31.0	31.1	32.3	32.3	36.6	40.6	44.8	49.3
Tax on goods and services	443.0	530.7	528.2	587.8	590.1	651.9	715.0	781.2	854.0
VAT	313.9	384.3	387.8	434.3	431.1	474.5	520.1	568.0	620.9
Excise	121.4	137.5	131.5	144.2	149.7	166.9	183.2	200.3	218.9
Other	7.7	8.8	8.9	9.3	9.3	10.6	11.7	12.9	14.2
Tax on international trade	24.5	28.7	28.7	31.5	31.6	34.5	37.7	41.2	45.0
Other tax	78.6	81.5	77.5	100.6	100.6	106.9	117.7	129.5	142.5
Nontax revenue	152.2	161.2	161.6	181.4	181.3	173.4	189.9	207.2	226.1
Expenditure	1,237.4	1,476.6	1,484.3	1,657.0	1,664.3	1,940.9	2,172.5	2,420.1	2,666.6
Current	1,135.6	1,320.6	1,337.4	1,488.5	1,495.8	1,742.5	1,952.3	2,177.3	2,399.1
Compensation of employees	315.5	383.6	383.6	431.8	431.8	550.0	638.7	731.6	829.2
Goods and services	198.4	227.8	227.8	276.3	276.3	312.8	347.0	382.7	421.7
Interest	111.7	132.5	132.5	148.1	148.1	151.6	167.1	182.2	190.5
Subsidies to corporations and enterprises	43.9	29.3	29.3	48.4	48.4	51.3	54.1	56.8	59.6
Social benefits	463.4	545.6	562.3	582.8	590.2	675.6	744.2	822.7	896.5
Social programs (on budget)	146.6	166.4	172.4	148.6	152.4	172.5	191.3	211.0	232.6
Pensions	293.2	345.8	356.6	396.4	400.0	461.6	508.1	563.9	613.0
Unemployment, disability, and accident	23.7	33.3	33.3	37.8	37.8	41.5	44.7	47.8	51.0
Other current expenditures	2.8	1.8	1.8	1.1	1.1	1.2	1.3	1.3	1.4
Capital	99.6	147.5	138.4	162.8	162.8	192.0	213.0	234.9	258.9
Net lending	2.1	6.8	6.8	4.0	4.0	4.5	5.0	5.5	6.1
Contingency reserve	0.0	1.7	1.7	1.7	1.7	1.9	2.2	2.4	2.6
Unidentified measures	0.0	0.0	0.0	0.0	0.0	95.5	133.2	174.3	191.9
General government overall balance	-65.3	-78.7	-86.2	-84.7	-90.1	-102.0	-108.2	-108.5	-119.5
General government financing	65.3	78.7	86.2	84.7	90.1	102.0	108.2	108.5	119.5
External	57.3	44.4	26.1	22.1	11.5	-8.6	3.7	53.3	6.1
Disbursements	127.0	98.7	98.2	143.9	111.1	122.5	117.8	144.4	99.3
Amortizations	-69.7	-54.3	-72.1	-121.8	-99.7	-131.1	-114.0	-91.1	-93.2
Domestic (net)	8.0	34.3	60.0	62.6	78.6	110.5	104.5	55.2	113.4
Bond financing 2/	-1.9	13.0	9.8	45.8	68.1	88.8	90.9	40.2	96.9
Direct bank borrowing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Deposit finance	6.6	0.0	50.0	-0.8	0.0	0.0	0.0	0.0	0.0
Privatization	3.4	21.3	0.2	17.6	10.5	21.8	13.6	15.0	16.5
Bank and DGF recapitalization	71.0	38.0	0.0	14.0	14.0	15.0	0.0	0.0	0.0
Memorandum items:									
Primary balance	46.3	53.8	46.4	63.3	58.0	49.7	58.9	73.7	71.0
Cyclically-adjusted primary balance 3/	66.2	70.4	55.8	78.0	64.8	53.1	61.4	74.2	71.8
Structural primary balance 3/ 4/	53.2	52.0	45.6	60.0	64.8	53.1	61.4	74.2	71.8
Public and publicly-guaranteed debt	2,144	2,610	2,248	2,519	2,519	2,653	2,760	2,820	2,910
Nominal GDP (billions of Ukrainian hryvnia)	2,983	3,329	3,447	3,916	3,916	4,433	4,918	5,420	5,970

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

1/ National methodology, cash basis.

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

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

4/ Advanced pension payments and part of the NBU profit transfer are considered one-off operations.

Table 2b. Ukraine: General Government Finances, 2017–2023 1/

(Percent of GDP)

	2017	2018		2019		2020	2021	2022	2023
	Act	Budget	Proj.	Budget	Proj.	Proj.	Proj.	Proj.	Proj.
Revenue	39.3	42.0	40.6	40.1	40.2	39.3	39.3	39.4	39.4
Tax revenue	34.2	37.2	35.9	35.5	35.6	35.4	35.4	35.6	35.7
Tax on income, profits, and capital gains	8.7	9.5	9.7	9.5	9.5	9.7	9.8	10.0	10.1
Personal income tax	6.2	6.8	6.7	6.8	6.8	7.0	7.1	7.3	7.4
Corporate profit tax	2.5	2.7	3.0	2.7	2.7	2.7	2.7	2.7	2.7
Social security contributions	6.2	7.4	6.9	6.8	6.8	7.0	7.1	7.3	7.3
Property tax	1.0	0.9	0.9	0.8	0.8	0.8	0.8	0.8	0.8
Tax on goods and services	14.9	15.9	15.3	15.0	15.1	14.7	14.5	14.4	14.3
VAT	10.5	11.5	11.3	11.1	11.0	10.7	10.6	10.5	10.4
Excise	4.1	4.1	3.8	3.7	3.8	3.8	3.7	3.7	3.7
Other	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2
Tax on international trade	0.8	0.9	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Other tax	2.6	2.4	2.2	2.6	2.6	2.4	2.4	2.4	2.4
Nontax revenue	5.1	4.8	4.7	4.6	4.6	3.9	3.9	3.8	3.8
Expenditure	41.5	44.4	43.1	42.3	42.5	43.8	44.2	44.6	44.7
Current	38.1	39.7	38.8	38.0	38.2	39.3	39.7	40.2	40.2
Compensation of employees	10.6	11.5	11.1	11.0	11.0	12.4	13.0	13.5	13.9
Goods and services	6.7	6.8	6.6	7.1	7.1	7.1	7.1	7.1	7.1
Interest	3.7	4.0	3.8	3.8	3.8	3.4	3.4	3.4	3.2
Subsidies to corporations and enterprises	1.5	0.9	0.8	1.2	1.2	1.2	1.1	1.0	1.0
Social benefits	15.5	16.4	16.3	14.9	15.1	15.2	15.1	15.2	15.0
Social programs (on budget)	4.9	5.0	5.0	3.8	3.9	3.9	3.9	3.9	3.9
Pensions	9.8	10.4	10.3	10.1	10.2	10.4	10.3	10.4	10.3
Unemployment, disability, and accident	0.8	1.0	1.0	1.0	1.0	0.9	0.9	0.9	0.9
Other current expenditures	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Capital	3.3	4.4	4.0	4.2	4.2	4.3	4.3	4.3	4.3
Net lending	0.1	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Contingency reserve	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Unidentified measures	0.0	0.0	0.0	0.0	0.0	2.2	2.7	3.2	3.2
General government overall balance	-2.2	-2.4	-2.5	-2.2	-2.3	-2.3	-2.2	-2.0	-2.0
General government financing	2.2	2.4	2.5	2.2	2.3	2.3	2.2	2.0	2.0
External	1.9	1.3	0.8	0.6	0.3	-0.2	0.1	1.0	0.1
Disbursements	4.3	3.0	2.9	3.7	2.8	2.8	2.4	2.7	1.7
Amortizations	-2.3	-1.6	-2.1	-3.1	-2.5	-3.0	-2.3	-1.7	-1.6
Domestic (net)	0.3	1.0	1.7	1.6	2.0	2.5	2.1	1.0	1.9
Bond financing 2/	-0.1	0.4	0.3	1.2	1.7	2.0	1.8	0.7	1.6
Direct bank borrowing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Deposit finance	0.2	0.0	1.5	0.0	0.0	0.0	0.0	0.0	0.0
Privatization	0.1	0.6	0.0	0.4	0.3	0.5	0.3	0.3	0.3
Bank and DGF recapitalization	2.4	...	0.0	0.4	0.4	0.3	0.0	0.0	0.0
Memorandum items:									
Primary balance	1.6	1.6	1.3	1.6	1.5	1.1	1.2	1.4	1.2
Cyclically-adjusted primary balance 3/	2.2	2.1	1.6	2.0	1.7	1.2	1.2	1.4	1.2
Structural primary balance 3/ 4/	1.8	1.6	1.3	1.5	1.7	1.2	1.2	1.4	1.2

Sources: Ministry of Finance; National Bank of Ukraine; and IMF staff estimates and projections.
1/ National methodology, cash basis.
2/ Domestic bonds have been adjusted to reflect discrepancy between the above-the-line and the below-the-line deficits.
3/ For the calculation of these balances, it is asumed that the unidentified measures are on the expenditure side.
4/ Advanced pension payments and part of the NBU profit transfer are considered one-off operations.

Table 3. Ukraine: Balance of Payments, 2017–2023 1/

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

	2017	2018	2019	2020	2021	2022	2023
		Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Current account balance	-2.4	-4.2	-3.9	-3.2	-5.6	-5.4	-4.7
Goods (net)	-9.4	-12.6	-13.5	-13.2	-14.3	-15.2	-15.6
Exports	39.7	43.0	43.4	46.0	48.5	51.8	55.8
Imports	-49.1	-55.5	-56.9	-59.2	-62.8	-67.0	-71.5
Of which : gas	-2.9	-3.4	-3.1	-2.8	-2.6	-2.4	-2.6
Services (net)	0.8	0.8	1.2	1.1	-0.8	-0.7	-0.5
Receipts	14.1	14.4	15.4	16.1	14.9	15.9	16.9
Payments	-13.3	-13.6	-14.2	-15.0	-15.7	-16.5	-17.3
Primary income (net)	2.7	3.9	4.3	4.4	4.7	5.1	5.6
Secondary income (net)	3.5	3.6	4.2	4.5	4.8	5.3	5.8
Capital account balance 2/	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account balance	-4.3	-4.2	-3.6	-5.7	-6.8	-10.0	-8.8
Direct investment (net) 3/	-2.6	-2.1	-2.2	-2.5	-2.6	-2.8	-3.1
Portfolio investment (net)	-1.8	-2.3	-0.6	-1.5	-1.9	-3.1	-2.6
Portfolio investment: assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Portfolio investment: liabilities	1.8	2.3	0.6	1.5	1.9	3.1	2.6
Financial derivatives (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment (net)	0.1	0.2	-0.8	-1.8	-2.3	-4.1	-3.1
Other investment: assets	0.9	1.9	-0.1	-1.0	-1.0	-1.9	-1.9
Other investment: liabilities	0.8	1.6	0.7	0.8	1.3	2.2	1.3
Central Bank	0.1	0.0	0.0	0.0	-0.2	-0.1	0.0
General government	0.5	0.4	0.6	-0.5	0.0	0.5	-1.0
Banks 3/	-1.5	-0.5	0.0	0.3	0.3	0.3	0.3
Other sectors	1.7	1.7	0.1	0.9	1.2	1.5	2.0
Errors and omissions	0.7	0.8	0.0	0.0	0.0	0.0	0.0
Overall balance	2.6	0.8	-0.3	2.6	1.2	4.6	4.1
Financing	-2.6	-0.8	0.3	-2.6	-1.2	-4.6	-4.1
Gross official reserves (increase: -)	-2.7	-0.1	-0.7	-1.5	0.1	-2.1	-0.7
Net use of IMF resources	0.1	-0.7	0.9	-1.1	-1.4	-2.5	-3.5
Of which: Prospective Fund purchases	1.0	1.4	2.5	0.0	0.0	0.0	0.0
Exceptional financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:							
Total external debt (percent of GDP)	104.1	95.5	92.3	86.7	82.4	78.8	74.4
Current account balance (percent of GDP)	-2.2	-3.3	-2.9	-2.2	-3.6	-3.2	-2.6
Goods and services trade balance (percent of GDP)	-7.7	-9.3	-9.2	-8.3	-9.7	-9.4	-8.9
Gross international reserves	18.8	18.8	19.5	20.9	20.8	22.9	23.5
Months of next year's imports of goods and services	3.3	3.2	3.1	3.2	3.0	3.1	3.2
Percent of the IMF composite metric	65.0	66.3	66.5	69.6	66.4	69.2	68.8

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.

Table 4. Ukraine: Gross External Financing Requirements, 2017–2023

(Billions of U.S. dollars)

	2017 Act.	2018 Proj.	2019 Proj.	2020 Proj.	2021 Proj.	2022 Proj.	2023 Proj.
Total financing requirements	57.0	57.93	46.0	48.3	50.6	51.2	52.4
Current account deficit	2.4	4.2	3.9	3.2	5.6	5.4	4.7
Portfolio investment	2.1	2.3	2.9	3.8	3.1	1.9	2.4
Private	0.1	0.6	1.2	1.4	0.7	0.5	1.1
General government	2.0	1.7	1.7	2.4	2.4	1.4	1.4
Medium and long-term debt	24.3	21.6	11.4	14.2	14.2	16.2	16.5
Private	24.0	21.2	10.7	12.7	13.3	15.2	15.4
Banks	0.3	0.7	0.5	0.5	0.5	0.6	0.6
Corporates	23.7	20.5	10.2	12.2	12.8	14.6	14.8
General government	0.4	0.4	0.7	1.5	0.9	1.0	1.0
Short-term debt (including deposits)	13.5	14.2	14.2	14.2	14.2	14.2	14.2
Other net capital outflows 1/	0.8	1.8	-0.1	-1.0	-1.0	-1.9	-1.9
Trade credit	13.8	13.8	13.8	13.9	14.5	15.4	16.4
Total financing sources	59.4	56.5	44.5	49.8	51.1	54.3	56.5
Capital transfers	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Direct investment, net	2.6	2.1	2.2	2.5	2.6	2.8	3.1
Portfolio investment	3.9	4.5	3.5	5.3	5.0	5.0	5.0
Private	0.4	0.9	0.5	2.3	2.0	2.0	2.0
General government	3.5	3.6	3.0	3.0	3.0	3.0	3.0
Of which: Eurobond issuance	3.2	2.7	3.0	3.0	3.0	3.0	3.0
Medium and long-term debt	26.9	21.8	10.7	13.2	13.7	15.6	16.1
Private	26.9	21.8	10.7	13.2	13.7	15.6	16.1
Banks	0.0	0.7	0.5	0.6	0.6	0.7	0.9
Corporates	26.9	21.1	10.2	12.5	13.2	15.0	15.2
Short-term debt (including deposits)	13.6	14.2	14.2	14.4	14.4	14.4	14.2
Trade credit	12.3	13.8	13.9	14.5	15.4	16.4	18.1
Increase in gross reserves	2.7	0.1	0.7	1.5	-0.1	2.1	0.7
Errors and omissions	0.7	0.8	0.0	0.0	0.0	0.0	0.0
Total financing needs	-0.4	0.8	2.2	-0.1	-0.6	-1.0	-3.5
Official financing	2.4	0.2	2.2	-0.1	-0.6	-1.3	-3.5
IMF	0.1	-0.7	0.9	-1.1	-1.4	-2.5	-3.5
Prospective purchases	1.0	1.4	2.5	0.0	0.0	0.0	0.0
Repurchases	0.9	2.1	1.6	1.1	1.4	2.5	3.5
Official creditors	2.3	0.9	1.3	1.0	0.7	1.2	0.0
World Bank	0.8	0.2	0.2	0.4	0.3	1.2	0.0
EU	0.6	0.6	0.6	0.0	0.0	0.0	0.0
EBRD/EIB/Others	0.9	0.1	0.5	0.6	0.4	0.0	0.0
Exceptional financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:							
Gross international reserves	18.8	18.8	19.5	20.9	20.8	22.9	23.5
Months of next year's imports of goods and services	3.3	3.2	3.1	3.2	3.0	3.1	3.2
Percent of short-term debt (remaining maturity)	41.1	53.1	50.4	54.0	50.0	50.4	51.4
Percent of the IMF composite metric 2/	65.0	66.3	66.5	69.6	66.4	69.2	68.8
Loan rollover rate (percent)							
Banks	86.7	100.0	100.0	104.9	104.6	104.6	104.6
Corporates	102.4	100.0	100.0	101.6	101.6	101.7	101.7
Total	99.6	100.0	100.0	102.4	102.3	102.3	102.3

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

2/ 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

Table 5. Ukraine: Monetary Accounts, 2017–2023

(Billions of Ukrainian hryvnia, unless otherwise noted)

	2017	2018	2019	2020	2021	2022	2023
	Act.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Monetary survey							
Net foreign assets	171	225	257	321	348	472	453
Net domestic assets	1,038	1,102	1,185	1,320	1,519	1,647	1,943
Domestic credit	1,748	1,885	2,001	2,227	2,455	2,645	2,909
Net claims on government	716	767	848	945	1,035	1,074	1,170
Credit to the economy	1,024	1,110	1,145	1,274	1,412	1,562	1,731
Domestic currency	577	594	596	667	756	869	1,001
Foreign currency	447	516	549	607	656	693	730
Other claims on the economy	8	8	8	8	8	8	8
Other items, net	-710	-783	-816	-907	-936	-998	-967
Broad money	1,209	1,328	1,443	1,641	1,866	2,119	2,396
Currency in circulation	333	373	406	437	470	506	544
Total deposits	876	954	1,036	1,204	1,396	1,612	1,851
Domestic currency deposits	491	546	588	720	875	1,061	1,262
Foreign currency deposits	386	408	449	484	521	552	590
Accounts of the NBU							
Net foreign assets	182	214	218	306	355	514	529
Net international reserves	187	219	223	311	361	520	536
(In billions of U.S. dollars)	6.7	7.5	7.2	9.7	10.9	15.5	15.5
Reserve assets	528	545	603	669	686	768	814
(In billions of U.S. dollars)	18.8	18.8	19.5	20.9	20.8	22.9	23.5
Other net foreign assets	-5	-4	-6	-6	-6	-6	-7
Net domestic assets	217	236	271	226	224	116	155
Net domestic credit	322	379	426	422	441	371	433
Net claims on government	322	351	346	327	314	302	288
Claims on government 1/	378	361	349	336	324	313	300
Net claims on banks	0	28	80	95	127	70	146
Other items, net	-106	-143	-155	-196	-217	-256	-278
Base money	399	450	489	532	579	629	684
Currency in circulation	333	373	406	437	470	506	544
Banks' reserves	67	77	83	95	109	124	140
Cash in vault	29	32	34	40	46	53	60
Correspondent accounts	38	45	49	55	63	71	80
Deposit money banks							
Net foreign assets	-11	11	40	16	-7	-42	-75
Foreign assets	165	183	196	202	208	212	219
Foreign liabilities	176	172	156	186	215	254	294
Net domestic assets	887	942	997	1,188	1,403	1,655	1,927
Domestic credit	1,531	1,618	1,691	1,933	2,156	2,431	2,649
Net claims on government 2/	393	416	502	618	721	773	882
Credit to the economy	1,024	1,112	1,145	1,273	1,412	1,562	1,731
Other claims on the economy	8	8	8	8	8	8	8
Net claims on NBU	106	83	37	34	16	88	27
Of which: refinancing loans 3/	69	60	76	95	130	75	151
Other items, net	-644	-676	-695	-745	-753	-776	-722
Banks' liabilities	876	954	1,036	1,204	1,396	1,612	1,851
Memorandum items:	(End of period, percent change unless						
Base money	4.6	12.9	8.5	8.8	8.9	8.7	8.7
Currency in circulation	5.8	12.3	8.7	7.6	7.6	7.6	7.7
Broad money	9.6	9.8	8.7	13.8	13.7	13.5	13.1
At program exchange rate	9.4	9.7	7.1	14.2	14.2	15.7	14.1
Credit to the economy	2.1	8.4	3.2	11.2	10.9	10.7	10.8
At program exchange rate	4.2	5.5	0.1	10.4	10.7	13.9	12.5
Real credit to the economy 4/	-10.1	-1.7	-3.6	5.4	5.4	5.3	5.5
Credit-to-GDP ratio, in percent	32.2	32.2	29.2	28.7	28.7	28.8	28.9
Velocity of broad money, ratio	2.47	2.60	2.71	2.70	2.63	2.56	2.50
Money multiplier, ratio	3.03	2.95	2.95	3.09	3.22	3.37	3.50
Hryvnia per U.S. dollar (end of period)	28.1	...	...	...	...	...	...

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

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

2/ Includes claims for recapitalization of banks.

3/ Includes regular liquidity provision operations in the forecast period.

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

Table 6. Ukraine: Structural and Financial Soundness Indicators for the Banking Sector, 2016–18

(Percent, unless otherwise indicated)

	2016		2017		2018
	Jun.	Dec.	Jun.	Dec.	Jun.
Ownership					
Number of banks, *of which 1/*	110	100	93	84	83
Private	103	93	86	79	78
Domestic	62	52	47	40	38
Foreign	41	41	39	39	40
Of which: 100% foreign-owned	17	19	18	19	23
State-owned	3	2	2	2	2
State-controlled (inc. in sanation)	4	5	5	3	3
Foreign-owned banks' share in statutory capital	51.2	51.0	34.7	34.3	34.3
Concentration					
Share of assets of largest 10 banks	72.4	72.2	75.4	75.7	76.5
Share of assets of largest 25 banks	90.7	91.4	93.1	93.4	93.3
Number of bank with assets less than $150 million	77	68	65	54	52
Capital Adequacy					
Regulatory capital to risk-weighted assets 2/	13.0	12.7	12.4	16.1	16.4
Regulatory Tier 1 capital to risk-weighted assets	9.0	9.0	9.2	12.1	11.2
Capital to total assets	11.1	9.8	11.1	11.9	10.3
Asset Quality					
Change of credit to GDP ratio (year-over-year, percentage points)	-15.1	-8.9	-9.8	-7.7	-4.3
NPLs to total loans (NBU definition) 3/	30.4	30.5	57.7	54.5	55.7
NPLs net of provisions to capital (NBU definition) 3/	93.6	89.4	96.3	70.2	62.2
Provisioning coverage ratio	65.8	72.7	77.3	81.1	86.7
Loan loss reserves to total (gross) loans	31.2	44.9	47.4	46.7	52.1
Foreign Exchange Rate Risk					
Loans in foreign currency to total loans	56.9	51.4	48.6	47.1	46.2
Deposits in foreign currency to total deposits	49.0	49.9	46.6	46.6	43.0
Foreign currency loans to foreign currency deposits	139.0	122.3	117.3	115.1	124.1
Net open FX position to capital 4/	122.5	118.9	109.8	89.6	138.8
Net open FX position to regulatory capital (staff estimate) 5/	-40.2	-100.8			
Liquidity Risk					
Liquid assets to total assets	38.4	48.5	53.0	53.9	54.2
Customer deposits to total loans to the economy	79.4	80.5	84.8	84.6	84.2
Earnings and Profitability					
Return on assets (after tax; end-of-period) 6/	-2.1	-12.3	-0.7	-2.0	0.5
Return on equity (after tax; end-of-period) 6/	-20.6	-115.0	-6.4	-17.2	4.0
Net interest margin to total assets	1.8	3.6	2.0	3.9	2.5
Interest rate spreads (percentage points; end-of-period)					
Between loans and deposits in domestic currency	8.7	7.3	6.9	8.0	9.1
Between loans and deposits in foreign currency	5.0	3.0	4.0	3.9	3.4
Between loans in domestic and foreign currency	12.1	9.6	8.5	11.0	11.8
Between deposits in domestic and foreign currency	8.4	5.4	5.6	6.9	6.0
Number of banks not complying with banking regulations					
Not meeting capital adequacy requirements for Tier I capital	11	10	10	3	2
Not meeting prudential regulations	33	39	32	32	31
Not meeting reserve requirements	9	7	3	3	3

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

1/ Excludes banks under liquidation.

2/Prior to 2017, capital does not reflect the impact of June 2016 Credit Risk Regulation (No 351), which came into effect January 3, 2017.

3/ From 2012-2016, NPLs consisted of loans in categories IV and V as recorded on the balance sheet; total gross loans included off-balance sheet obligations on guarantees and loans used for credit assessments. Since 1th quarter of 2017 NPLs include loans classified into the lowest class, in particular: class 10 - loans to corporate borrowers (excluding banks and state owned entities); class 5 - loans to other borrowers/counterparties accounted; total gross loans as debts arising from credit transactions, including loans to customers, interbank loans and deposits, excluded off-balance sheet obligations on guarantees and loans given to banks and customers, used for credit risk assessment.

4/ Calculated according to IMF STA guidelines, with net open position equal to the sum of the absolute value of the net open position in individual foreign currencies.

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

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

Table 7. Ukraine: Indicators of Fund Credit, 2017–2026
(In millions of SDR)

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
	Actual	Projections								
Existing Fund credit										
Stock 1/	8,522	7,036	5,883	5,095	4,126	3,096	2,067	1,037	303	61
Obligations	853	430	1,359	959	1,097	1,120	1,099	1,078	762	260
Principal (repurchases)	629.0	372	1,153	788	969	1,030	1,030	1,030	734	242
Interest charges	224.0	58	206	171	129	90	69	48	27	18
Prospective purchases										
Disbursements	0.0	1,000	1,800	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Stock 1/	0.0	1,000	2,800	2,800	2,800	2,075	675	0.0	0.0	0.0
Obligations 2/	0.0	5.0	74	146	152	857	1,457	685	0.3	0.0
Principal (repurchases)	0.0	0.0	0.0	0.0	0.0	725	1,400	675	0.0	0.0
Interest charges	0.0	5.0	73.7	146.0	152.0	132.5	57.5	10.2	0.3	0.0
Stock of existing and prospective Fund credit 1/	8,522	8,036	8,683	7,895	6,926	5,171	2,742	1,037	303	61
In percent of quota 3/	424	399	432	392	344	257	136	52	15.1	3.0
In percent of GDP	5.4	4.5	4.5	3.8	3.1	2.1	1.0	0.3	0.1	0.0
In percent of exports of goods and nonfactor services	11.2	9.9	10.4	8.9	7.6	5.3	2.6	1.0	0.3	0.1
In percent of gross reserves	32.0	30.4	31.3	26.5	23.4	15.9	8.2	3.1	0.9	0.2
In percent of public external debt	13.1	11.8	11.7	10.9	9.5	7.1	3.7	1.4	0.4	0.1
Obligations to the Fund from existing and prospective Fund credit	853	435	1,433	1,105	1,249	1,977	2,556	1,763	762	260
In percent of quota	42.4	21.6	71.2	54.9	62.1	98.3	127.1	87.6	37.9	12.9
In percent of GDP	0.5	0.2	0.7	0.5	0.6	0.8	1.0	0.5	0.2	0.1
In percent of exports of goods and nonfactor services	1.1	0.5	1.7	1.2	1.4	2.0	2.4	1.7	0.7	0.2
In percent of gross reserves	3.2	1.6	5.2	3.7	4.2	6.1	7.7	5.3	2.3	0.8
In percent of public external debt service	20.4	9.7	32.4	19.2	25.1	38.1	49.2	33.9	14.7	5.0

Source: Fund staff estimates and projections.

1/ End of period.

2/ Repayment schedule based on repurchase obligations and GRA charges. Includes service charges.

3/ Ukraine's quota is SDR 2011.8 million effective since Febrauary 2016.

Table 8. Ukraine: Schedule of Reviews and Available Purchases

Availability Date	Condition	Amount of Purchase		
		(SDR billions)	(USD billions)	(Percent of quota)
18-Dec-18	Approval of the 14-month SBA	1.0	1.4	49.7
15-May-19	Completion the first review based on end-March 2019 performance criteria	0.9	1.3	44.7
15-Nov-19	Completion the second review based on end-September 2019 performance criteria	0.9	1.3	44.7
Total available		2.8	3.9	139

Source: Fund staff estimates and projections.

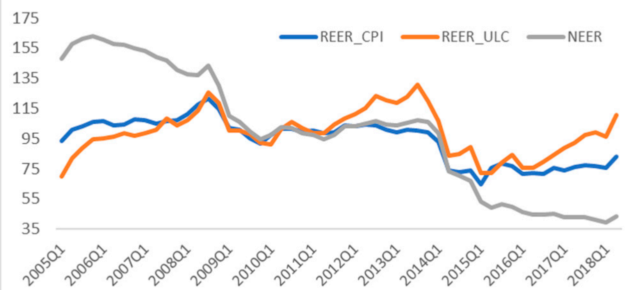
Annex I. External Sector Assessment

Staff's overall assessment is that Ukraine's external position in 2018 is broadly in line with fundamentals. Competitiveness has been affected by a series of negative shocks, including to production capacity due to the conflict in the eastern part of Ukraine and rising real wages. The policy assumptions underpinning this assessment hinge upon the timely and steadfast implementation of the program. Reserves would remain at adequate levels although well below 100 percent of the composite metric. Risks to the outlook stem from policy slippages and political uncertainty, adverse terms of trade shocks, financial market volatility, and a possible escalation of the conflict in eastern Ukraine.

Real Exchange Rate

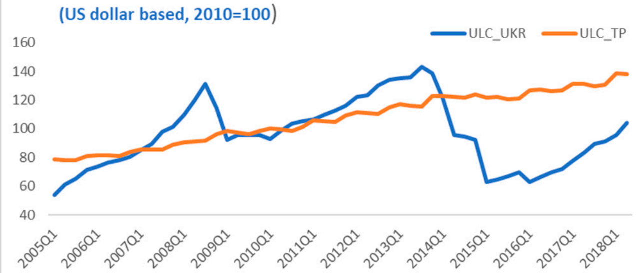
1. **Ukraine's competitiveness improved markedly in 2014 after moving to a flexible exchange rate regime, but some of those gains have been eroded in recent years.** The nominal effective exchange rate has depreciated in the last few years and while inflation has been declining, it remains relatively high compared to trading partners. On balance, the real effective exchange rate has been gradually appreciating. The appreciation of the REER in unit-labor cost terms is more pronounced. This is in part explained by the large migration of workers to new markets (mostly Poland), which has led to a sizable increase in remittances inflows but also to an upward pressure on wages in Ukraine as firms compete for workers.

Effective Exchange Rates



Source: Haver, NBU, and IMF stafff calculations

ULC
(US dollar based, 2010=100)

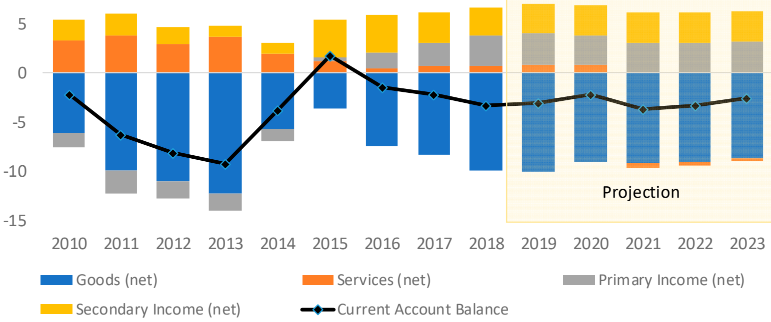


Source: Haver, NBU, and IMF stafff calculations

2. **Trade tensions continue to affect the external outlook.** On the one hand, more than four years after its beginning, the conflict in the eastern part of Ukraine continues, with no clear resolution in sight. More recently, the construction by Russia of a bridge in the Sea of Azov has resulted in delays in transportation of mostly metallurgical products from the eastern part of Ukraine. In some cases, companies have had to switch to transporting their production via rail, at an increased cost and with lower efficiency. The recent financial market turmoil in Turkey, one of Ukraine's main trading partners, is also adversely affecting Ukrainian exports. Trade tensions between the US and China and the associated tariffs have so far had limited impact on Ukrainian exports, but this could change quickly if trade measures were to escalate and spread.

3. The current account widened in 2018 to about 3 percent of GDP due to increased imports and dividend repatriations. Exports recovered, after the drought of 2017 that had hurt agriculture, but robust domestic demand led a faster increase in imports. Tourism has been permanently impacted by Russia's annexation of Crimea. A pick-up in remittances has provided sizable inflows, however, that help finance the current account deficit. Going forward, the completion of the Nord Stream 2 pipeline could result in large losses in transit fees for Ukraine. The baseline assumes a considerable reduction in transit fees starting in 2021.

Current Account (percent of GDP)



Source: Haver, NBU, and IMF stafff calculations

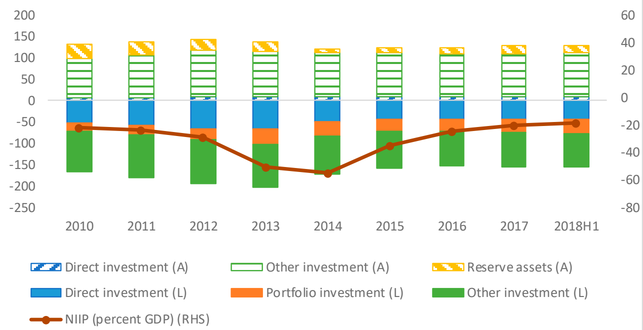
4. Staff assesses the external position to be in line with fundamentals. Both the current account (CA) and the external sustainability models point to the exchange rate being in line with fundamentals. On the other hand, the effective exchange rate index model points to a slight overvaluation of the hryvnia of about 10 percent.

2018 REER gap estimates	
EBA-lite CA model	-2.5
EBA-lite ES model	4.8
EBA-lite REER model	-10.3

Foreign Asset and Liability Position

5. Ukraine's international investment position has marginally improved in recent years. This was the result lower current account deficits, but also lower FDI and other inflows into the economy. Going forward, it is expected to deteriorate to about 27 percent in 2023, as Ukraine continues to tap international markets, and more capital is projected to flow into the economy.

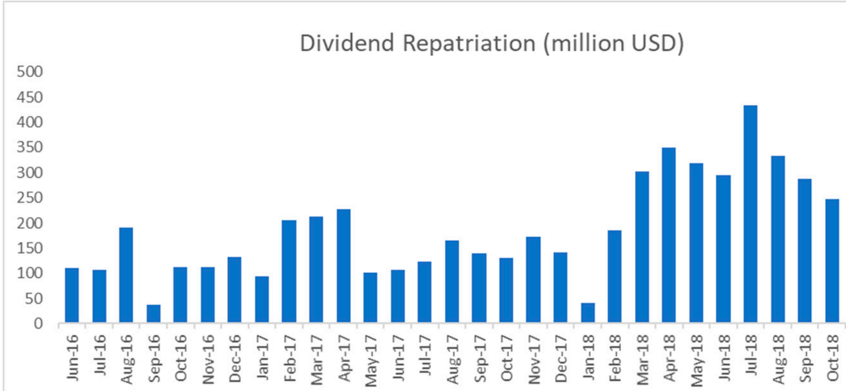
Net International Investment Position (billion USD)



Source: Haver, NBU, and IMF stafff calculations

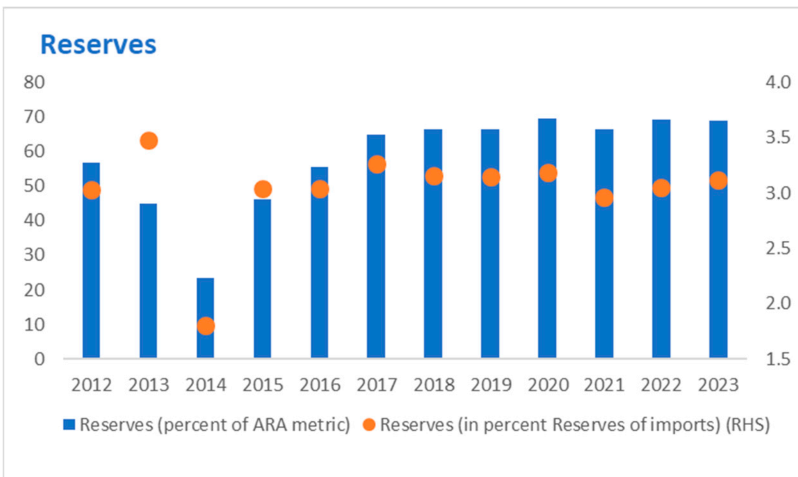
Capital and Financial Account Flows and Policy Measures

6. **Ukraine has maintained access to international capital markets and has continued building reserves**. Most net inflows of FDI since 2015–16 have been directed at the banking sector, as debt-to-equity or debt-forgiveness operations between subsidiaries and parent banks. In early 2018, non-resident purchased domestic government securities, but these flows reversed in the fall as the outlook for emerging markets deteriorated. The introduction of Clearstream in 2019 could facilitate further inflows of non-residents into the Ukrainian securities market. The NBU has also continued with the gradual removal of foreign exchange restrictions. As a result, dividend repatriations increased substantially in 2018, reaching US$2.8 billion in the first ten months of the year, compared to US$1.8 billion in the whole of 2017.



Source: NBU and IMF stafff calculations

7. **Ukraine's gross international reserves have reached an adequate level, but further efforts should be made to build additional buffers.** Ukraine has made considerable efforts in recent years to rebuild its international reserves. However, these fall short from the levels suggested by the IMF's reserve adequacy metric. The 2015 EFF envisioned surpassing 100 percent of the metric by the end of the program. Delays in program implementation and additional external challenges made reaching this target unattainable. Under the proposed SBA, Ukraine would be able to meet its sizable external obligations in coming years while maintaining its current reserve buffers.



Annex II. Debt Sustainability Analysis

Public debt is expected to decline to just over 65 percent of GDP by the end of 2018 and to continue on a sustainable downward path in the medium-term, falling to below 50 percent of GDP in 2023. A strong fiscal adjustment effort and the return of economic growth have helped bring down debt from its peak of 85 percent of GDP in 2016. The debt outlook remains subject to significant risks, however, and debt indicators could worsen substantially in case of exchange rate or growth shocks, either of which could be triggered by policy slippages, a worsening external environment, or an intensification of regional tensions.

A. Key Assumptions in the DSA

1. The main assumption in the macroeconomic framework are:

- *Real GDP growth*. Growth is projected to reach 3.3 percent in 2018 and remain around that level in the medium-term. In the absence of structural reforms, potential GDP is also estimated at 3.3 percent.

- *Exchange rate*. The average exchange rate stood at UAH27.4/$ so far in 2018. It is expected that relatively contained current account deficits and continued capital inflows would continue supporting a small real exchange rate appreciation over the medium term.

- *Inflation*. Inflation (measured by the GDP deflator) is set to decline to 12 percent in 2018 and is expected to continue to decline to about 6.5 percent in the medium-term.

- *Fiscal deficits*. In 2018 the fiscal deficit (including Naftogaz) is expected to be around 2.5 percent of GDP (assuming that budget spending will accelerate in the last months of the year), and it will decline slightly to 2.3 percent of GDP in 2019. The primary balance will remain at around 1.5 percent of GDP in 2018 and 2019. In cyclically adjusted terms, this implies a modest easing of the fiscal stance, although it on balance still represents a fiscal adjustment of around 4 percentage points of GDP since 2013. Assuming that the authorities will continue to pursue sound fiscal policies, primary surpluses between 1 and 1.5 percent of GDP are projected throughout the projection period.

2. Other identified debt-creating/reducing flows.

- *Banking system support*. With much of the rehabilitation of the banking system achieved, and with stronger capital buffers and improved NPL provisioning, the projected additional fiscal costs for 2019 and 2020 are projected at about 0.4 percent of GDP.

- *Issuance of guaranteed debt*. During 2018, guarantees amounted to about 0.7 percent of GDP. For 2019, it is assumed that the issuance of new guarantees would remain at 0.6 percent of GDP and will be limited to 0.3 percent of GDP per year from 2020 onwards due to the expected reduced demand brought about by the privatization and corporatization of state-owned enterprises.

- *Privatization proceeds*. For the period 2018–23, the baseline assumes no proceeds from privatization.

3. Official financing. Multilateral financing is expected from the EU under its Macro-Financial Assistance program for €1 billion. The World Bank is expected to provide a Policy-Based Guarantee for USD750 million that would allow Ukraine to borrow up to US$ 1 billion. IMF lending under the current program is on SBA terms.

4. Market access. Ukraine has regained market access and has been able to tap international markets in the last two years. In 2018, Ukraine made a private placement in September in the amount US$ 725million and issued US$ 2 billion in bonds in November. The expected World Bank Policy-Based Guarantee would allow Ukraine to borrow up to US$ 1 billion at more favorable terms. Thanks to the adjustment efforts of recent years, gross financing needs during the post-program period would remain well below the high-risk benchmark in the debt sustainability framework, which would help ensure the needed continuous market access.

B. Public Sector DSA

5. 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 include non-guaranteed SOEs domestic and external liabilities.

6. Baseline projections indicate that the debt ratio would fall below 50 percent of GDP by 2023 (Figure 3). After peaking at 85 percent in 2016, public debt declined substantially, mostly on the back of the fiscal adjustment and the improved interest rate-growth differential. Reduced recapitalization costs for banks and Naftogaz relative to the previous DSA help improve the debt dynamics. The projected decline in public in the medium-term is driven by sustained fiscal adjustment and continued real growth, as well as a modest real exchange rate appreciation.

7. A heat map and fan charts indicate that Ukraine risks to debt sustainability have declined but remain significant (Figure 1). The worsening external environment for emerging markets could lead to a sharp increase in borrowing costs for Ukraine. On the domestic front, the upcoming elections could also have an impact on rollover rates and overall financing costs. These risks are somewhat alleviated by the lower debt level and gross financing needs. Another source of vulnerability is the large share of debt denominated in foreign currency, making Ukraine highly vulnerable to large movements of the exchange rate. The large share of public debt held by nonresidents (two-thirds of total debt) also poses some risks, although this is mitigated by the large holdings of debt by official creditors. Going forward, as Ukraine continues to repay much of its debt to official creditors, it a prudent debt management strategy will be necessary to ensure that the improved debt dynamics are preserved.

Public and Publicly Guaranteed Debt 2018

	UAH (billion)	USD (billion)	percent of GDP	percent of total
Public and publicly guaranteed debt	2,248.3	82.2	65.2	100.0
Domestic debt	780.4	28.5	22.6	34.7
Direct debt in UAH	628.3	23.0	18.2	27.9
Direct debt in FX	122.2	4.5	3.5	5.4
Guaranteed	29.9	1.1	0.9	1.3
External debt	1,467.9	53.6	42.6	65.3
Multilateral 1/	343.0	12.5	10.0	15.3
of which: IMF budget support	152.1	5.6	4.4	6.8
Bilateral 2/	170.1	6.2	4.9	7.6
Sovereign Eurobonds	645.0	23.6	18.7	28.7
Local government Eurobonds 3/	9.6	0.3	0.3	0.4
External guaranteed debt	300.2	11.0	8.7	13.4
of which: IMF loans to NBU	231.0	8.4	6.7	10.3

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

8. **Stress tests suggest that the debt profile is most vulnerable to a real exchange rate shock and a real GDP shock.** The shock scenarios also point to risks related to larger-than-expected financing needs, including to support the banking sector. However, under the baseline, owing to the efforts made so far, 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 2015 EFF approval. Under stress tests, only the combined shock has a substantial impact on gross financing needs, raising these to an average of more than 15 percent of GDP during the projection period.

C. External Sector DSA

9. **Baseline projections suggest that external debt would drop to about 80 percentage points of GDP by 2023**. Gross external debt has declined to about 100 percent, after peaking at 130 percent of GDP in 2015. The medium-term sustainability of external debt is underpinned by a moderate external adjustment. Exports of goods and services are expected to decline in 2021 as gas transit fees decline following the projected start of operations of the Nord Stream 2 pipeline. However, continued strong performance by other exports and limited increases of imports would keep the trade balance at relatively constant levels. The downward path of external debt is also supported by the impact of the debt operation through the primary income balance in the current account, as well as by the sizable inflow of remittances.

10. **External debt dynamics are subject to downside risks stemming from macroeconomic shocks or a quick reversal of the recent external adjustment** (Figure 6). Increased international trade tensions, worsening financial conditions for emerging markets, and/or a faster than expected

normalization in interest rates in advanced economies could undo the adjustment of the current account deficit at the time when imports start to respond to the recovery in growth. FDI flows are projected to continue mainly in the form of debt-to-equity operations. Looking ahead, since the baseline assumes no acceleration in structural reforms, a less uncertain political outlook and deeper structural reforms could lead to a resumption of non-debt creating inflows into the economy. The historical scenario, with the main macro variables constant at their 10-year historical average, generates unsustainable debt dynamics. Similar to the public DSA, external debt dynamics are also highly vulnerable to an exchange rate shock.

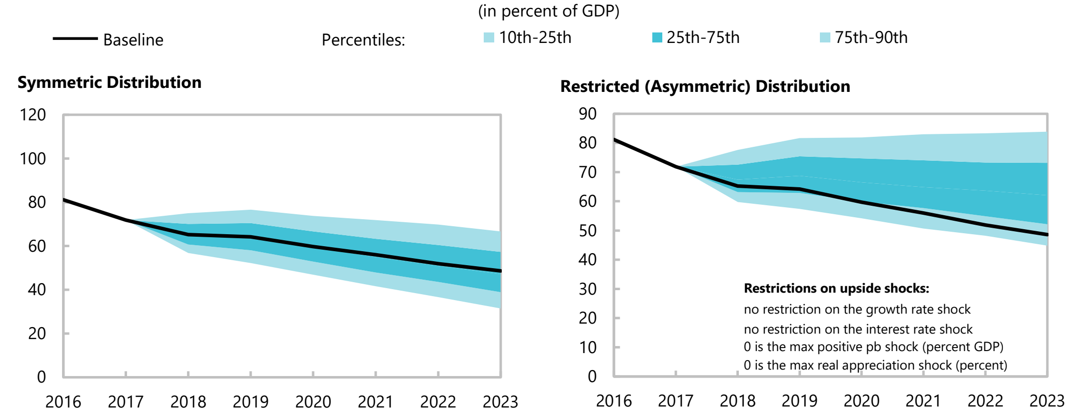
Annex II. Figure 1. Ukraine: Public DSA Risk Assessment

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

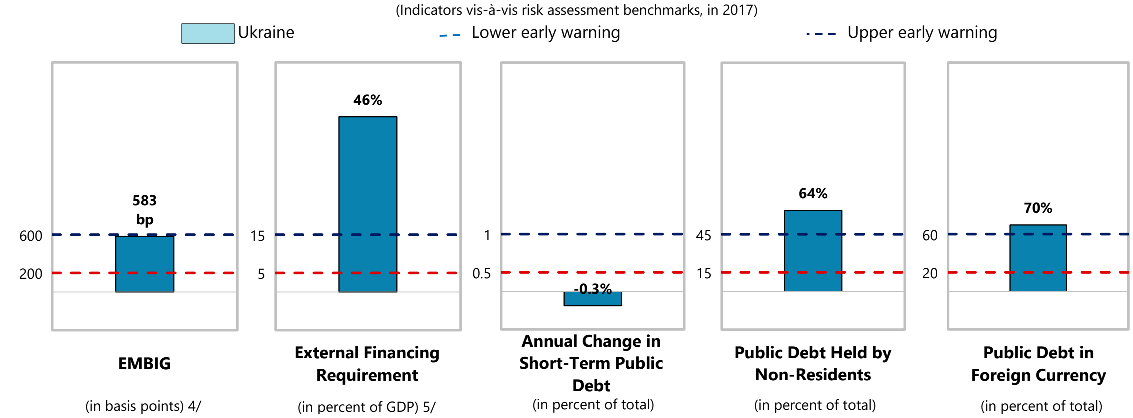
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2017)



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.

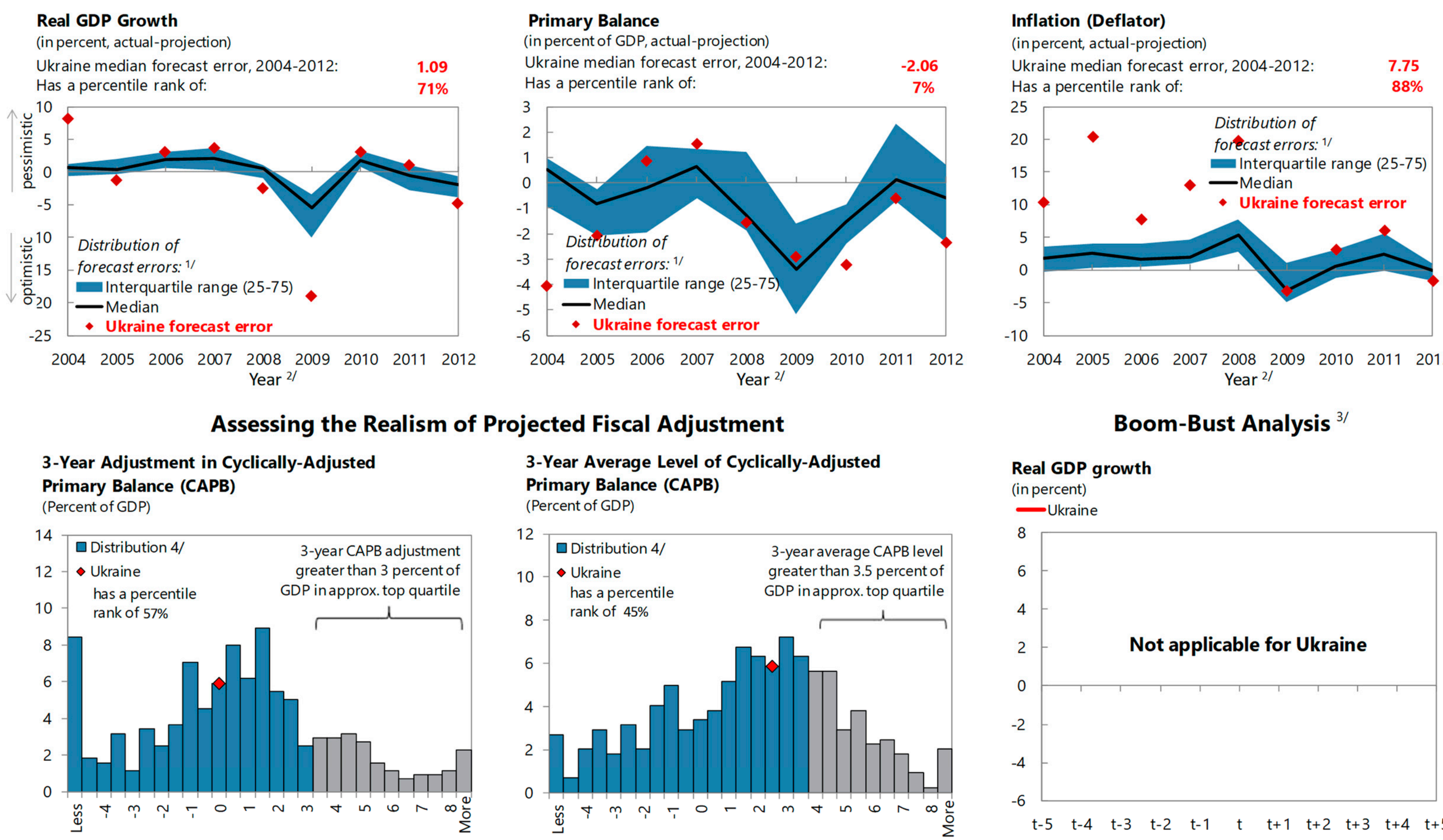
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, 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, 22-Aug-18 through 20-Nov-18.

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 II. 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 II. Figure 3. Ukraine: Public DSA—Baseline Scenario

(in percent of GDP unless otherwise indicated)

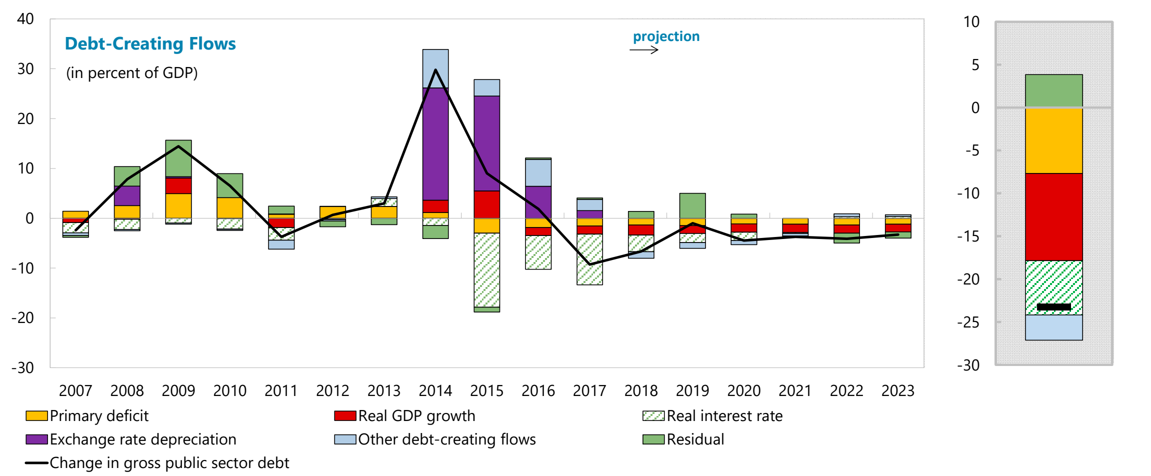
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2007-2015 [2/]	2016	2017	2018	2019	2020	2021	2022	2023
Nominal gross public debt	41.2	81.2	71.9	65.2	64.2	59.7	56.0	51.9	48.6
Of which: guarantees	7.2	11.7	10.1	9.6	10.5	9.0	7.4	5.5	3.8
Public gross financing needs	8.6	12.2	9.6	9.1	8.5	8.8	7.2	6.1	6.2
Real GDP growth (in percent)	-1.7	2.4	2.5	3.3	2.7	3.0	3.1	3.2	3.3
Inflation (GDP deflator, in percent)	17.7	17.1	22.0	11.9	10.6	9.9	7.6	6.8	6.7
Nominal GDP growth (in percent)	15.6	20.0	25.1	15.5	13.6	13.2	10.9	10.3	10.2
Effective interest rate (in percent) [4/]	7.5	7.3	6.7	7.0	7.7	7.3	7.5	7.7	7.6

As of July 20, 2018		
Sovereign Spreads		
EMBIG (bp) 3/		646
5Y CDS (bp)		474
Ratings	Foreign	Local
Moody's	Caa2	Caa2
S&Ps	B-	B-
Fitch	B-	B-

Contribution to Changes in Public Debt

	Actual			Projections							
	2007-2015	2016	2017	2018	2019	2020	2021	2022	2023	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	7.2	1.8	-9.3	-6.7	-1.0	-4.5	-3.7	-4.1	-3.3	-23.3	
Identified debt-creating flows	6.0	1.6	-9.6	-8.0	-6.0	-5.3	-3.6	-2.1	-2.0	-27.1	
Primary deficit	1.9	-1.9	-1.6	-1.3	-1.5	-1.1	-1.2	-1.4	-1.2	-7.7	0.0
Primary (noninterest) revenue and grants	42.2	38.3	39.3	40.6	40.2	39.3	39.3	39.4	39.4	238.2	
Primary (noninterest) expenditure	44.1	36.5	37.7	39.2	38.7	38.2	38.1	38.0	38.2	230.5	
Automatic debt dynamics [5/]	3.2	-2.0	-10.3	-5.3	-3.4	-3.3	-1.9	-1.3	-1.2	-16.5	
Interest rate/growth differential [6/]	-1.9	-8.4	-11.8	-5.3	-3.4	-3.3	-1.9	-1.3	-1.2	-16.5	
Of which: real interest rate	-2.7	-6.8	-10.2	-3.3	-1.8	-1.7	-0.2	0.3	0.3	-6.3	
Of which: real GDP growth	0.9	-1.6	-1.6	-2.0	-1.6	-1.7	-1.7	-1.6	-1.5	-10.1	
Exchange rate depreciation [7/]	5.1	6.4	1.5	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.9	5.4	2.3	-1.3	-1.1	-0.8	-0.5	0.5	0.4	-2.9	
General government financing: Domestic (net): Priv	-0.5	0.0	-0.1	0.0	-0.3	-0.5	-0.3	-0.3	-0.3	-1.6	
Bank and Naftogaz recapitalization	1.4	5.4	2.4	0.0	0.4	0.3	0.0	0.0	0.0	0.7	
Other adjustments	0.0	0.0	0.0	-1.3	-1.2	-0.7	-0.3	0.8	0.6	-2.0	
Residual, including asset changes [8/]	1.2	0.3	0.3	1.4	5.0	0.8	-0.1	-2.0	-1.3	3.9	



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).

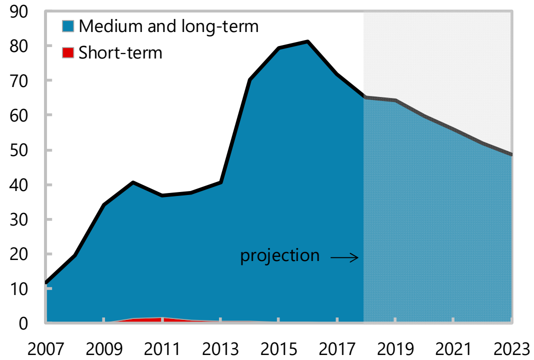
8/ Includes changes in the stock of guarantees (including IMF financing to NBU), and asset changes. For projections, includes exchange rate changes during the projection period.

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.

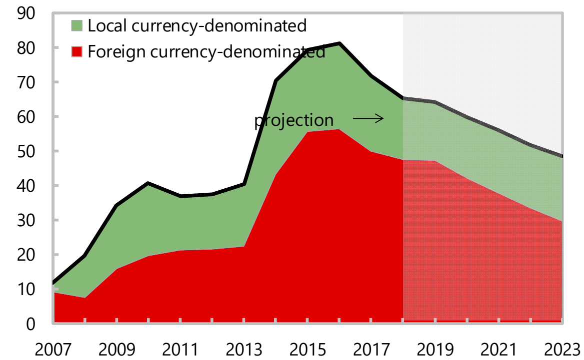
Annex II. Figure 4. Ukraine: Public DSA—Composition of Public Debt and Alternate Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



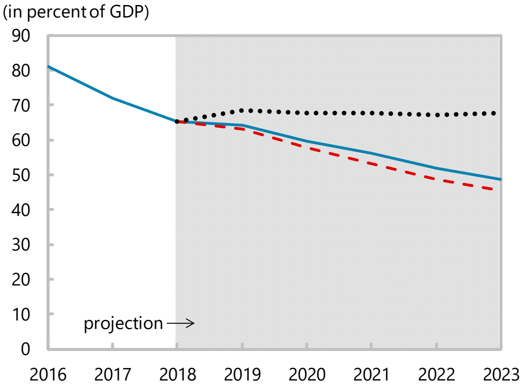
By Currency
(in percent of GDP)



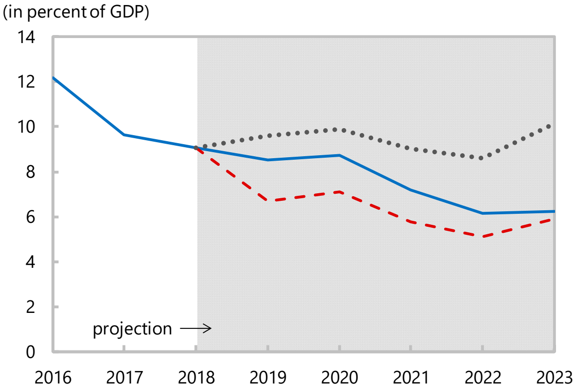
Alternative Scenarios

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)

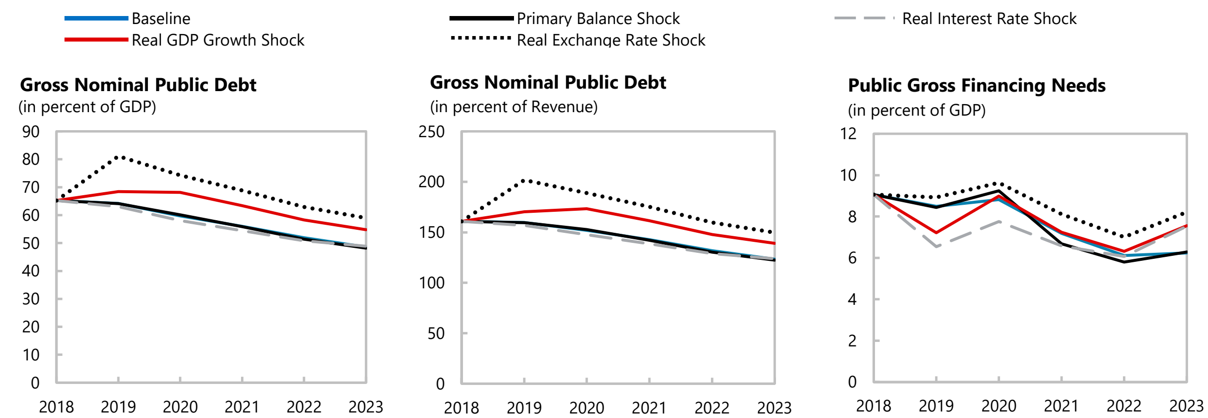
Baseline Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	3.3	2.7	3.0	3.1	3.2	3.3
Inflation	11.9	10.6	9.9	7.6	6.8	6.7
Primary Balance	1.3	1.5	1.1	1.2	1.4	1.2
Effective interest rate	6.9	7.7	7.2	7.4	7.6	7.7
Constant Primary Balance Scenario						
Real GDP growth	3.3	2.7	3.0	3.1	3.2	3.3
Inflation	11.9	10.6	9.9	7.6	6.8	6.7
Primary Balance	1.3	1.3	1.3	1.3	1.3	1.3
Effective interest rate	6.9	6.9	6.5	6.9	7.1	7.1

Historical Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	3.3	-1.8	-1.8	-1.8	-1.8	-1.8
Inflation	11.9	10.6	9.9	7.6	6.8	6.7
Primary Balance	1.3	-1.2	-1.2	-1.2	-1.2	-1.2
Effective interest rate	6.9	6.9	5.6	5.0	4.6	4.0

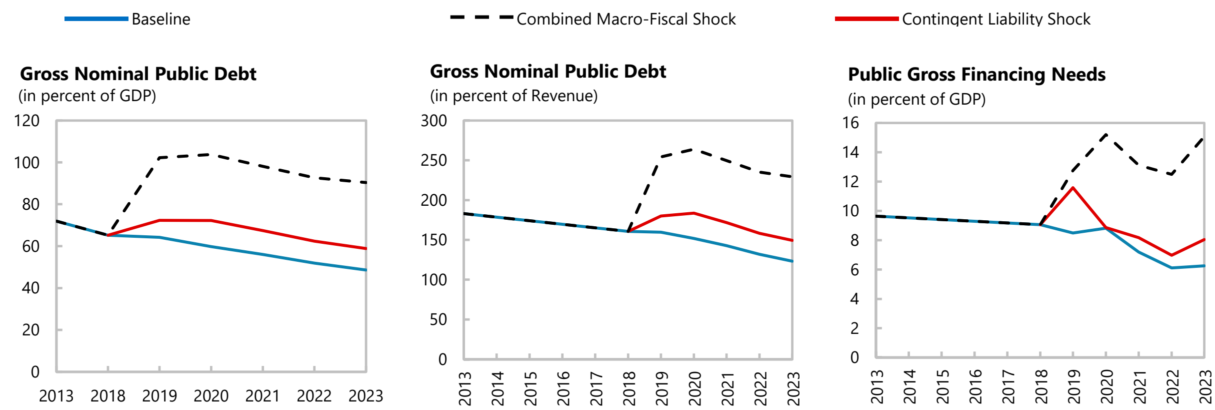
Source: IMF staff.

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

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

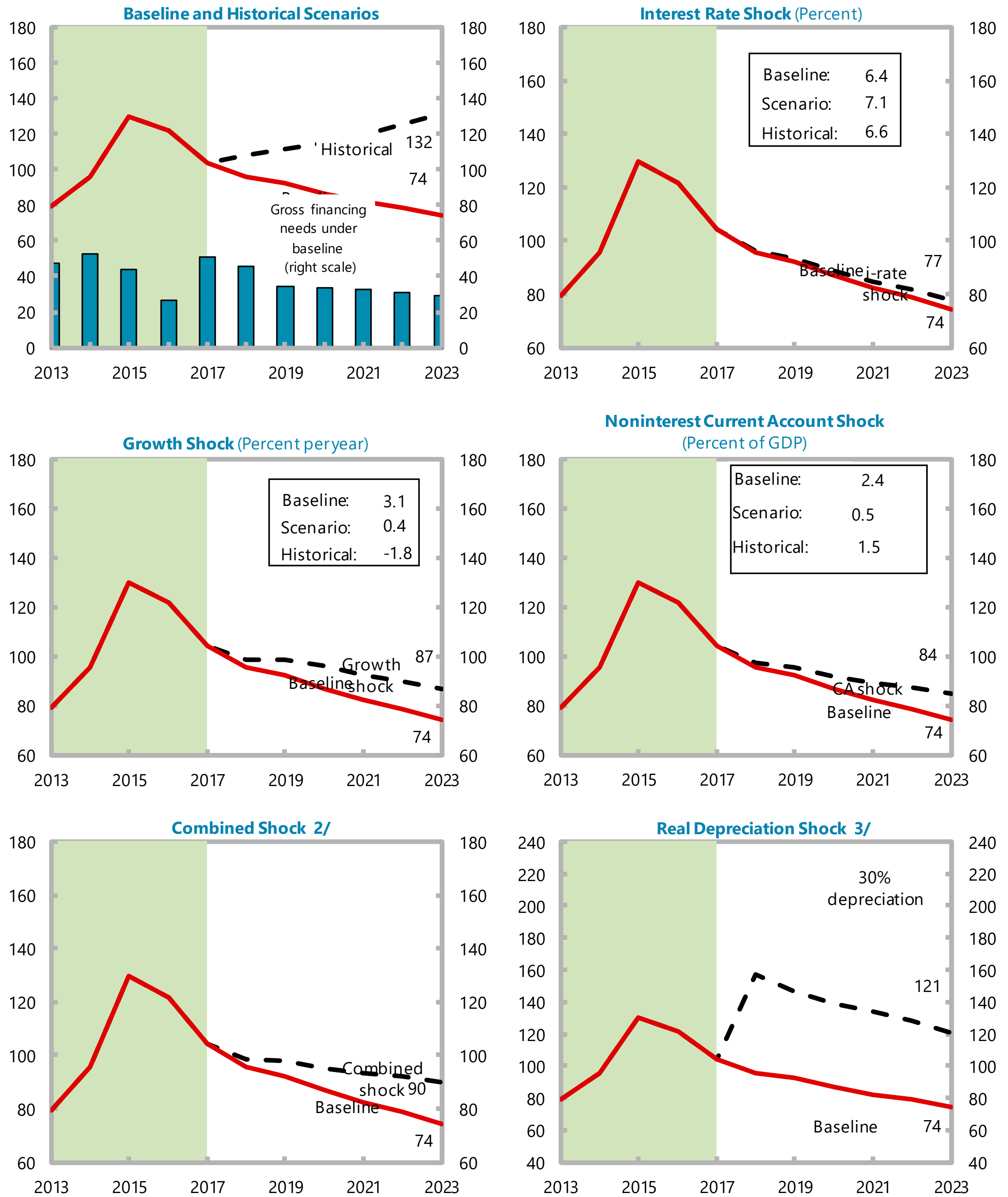
Primary Balance Shock	2018	2019	2020	2021	2022	2023
Real GDP growth	3.3	2.7	3.0	3.1	3.2	3.3
Inflation	11.9	10.6	9.9	7.6	6.8	6.7
Primary balance	1.3	0.2	-0.2	1.2	1.4	1.2
Effective interest rate	7.0	6.9	6.6	7.0	7.2	7.1
Real Interest Rate Shock						
Real GDP growth	3.3	2.7	3.0	3.1	3.2	3.3
Inflation	11.9	10.6	9.9	7.6	6.8	6.7
Primary balance	1.3	1.5	1.1	1.2	1.4	1.2
Effective interest rate	7.0	6.9	7.2	8.4	9.1	9.6
Combined Shock						
Real GDP growth	3.3	-3.8	-3.5	3.1	3.2	3.3
Inflation	11.9	9.0	8.3	7.6	6.8	6.7
Primary balance	1.3	0.2	-0.2	1.2	1.4	1.2
Effective interest rate	7.0	8.9	6.3	7.8	8.6	9.3

Real GDP Growth Shock	2018	2019	2020	2021	2022	2023
Real GDP growth	3.3	-3.8	-3.5	3.1	3.2	3.3
Inflation	11.9	9.0	8.3	7.6	6.8	6.7
Primary balance	1.3	1.5	1.1	1.2	1.4	1.2
Effective interest rate	7.0	6.9	6.6	7.0	7.1	7.1
Real Exchange Rate Shock						
Real GDP growth	3.3	2.7	3.0	3.1	3.2	3.3
Inflation	11.9	26.8	9.9	7.6	6.8	6.7
Primary balance	1.3	1.5	1.1	1.2	1.4	1.2
Effective interest rate	7.0	8.9	6.1	6.6	6.8	6.8
Contingent Liability Shock						
Real GDP growth	3.3	-3.8	-3.5	3.1	3.2	3.3
Inflation	11.9	9.0	8.3	7.6	6.8	6.7
Primary balance	1.3	-2.5	1.1	1.2	1.4	1.2
Effective interest rate	7.0	7.6	6.6	7.0	7.2	7.1

Source: IMF staff.

Annex II. 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 II. Table 1. Ukraine: Program External Debt Sustainability Framework, 2013–2023

(Percent of GDP, unless otherwise indicated)

	Actual							Projections						Debt-stabilizing non-interest current account 6/
	2013	2014	2015	2016	2017			**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	
Baseline: external debt	79.1	95.4	130.0	121.7	104.1			95.5	92.3	86.7	82.4	78.8	74.4	-2.5
Change in external debt	2.5	16.3	34.5	-8.3	-17.6			-8.6	-3.1	-5.6	-4.4	-3.6	-4.4	
Identified external debt-creating flows (4+8+9)	4.6	32.2	38.2	-5.5	-18.0			-1.6	-1.5	-2.7	-1.3	-1.6	-2.3	
Current account deficit, excluding interest payments	3.2	-1.5	-7.8	-4.3	-3.5			-2.1	-2.7	-3.3	-1.6	-1.8	-2.5	
Deficit in balance of goods and services	8.7	3.9	2.4	7.0	7.7			8.7	8.5	7.7	9.0	8.8	8.3	
Exports	45.5	49.4	52.6	49.3	48.0			42.8	40.6	39.9	37.7	37.5	37.7	
Imports	54.2	53.3	55.1	56.3	55.6			51.5	49.1	47.6	46.8	46.3	46.0	
Net non-debt creating capital inflows (negative)	-2.9	0.1	-3.5	-3.6	-2.1			-2.0	-2.0	-2.4	-2.4	-2.4	-2.5	
Automatic debt dynamics 1/	4.4	33.6	49.5	2.4	-12.5			2.5	3.2	3.0	2.7	2.6	2.7	
Contribution from nominal interest rate	6.0	5.3	6.0	5.8	5.8			5.5	5.7	5.6	5.3	5.0	5.1	
Contribution from real GDP growth	0.0	7.0	13.6	-3.1	-2.6			-3.1	-2.5	-2.6	-2.5	-2.4	-2.4	
Contribution from price and exchange rate changes 2/	-1.7	21.2	29.9	-0.3	-15.7			...	...	...	...	...	...	
Residual, including change in gross foreign assets (2-3) 3/	-2.1	-15.8	-3.7	-2.8	0.4			-7.0	-1.7	-2.9	-3.1	-1.9	-2.1	
External debt-to-exports ratio (percent)	173.9	193.0	246.9	247.0	217.1			223.2	227.5	217.5	218.2	210.1	197.2	
Gross external financing need (billions of U.S. dollars) 4/	85.5	69.9	40.2	24.6	57.0			57.0	57.9	46.0	48.3	50.6	51.2	
Percent of GDP	47.6	52.8	44.2	26.4	50.8			45.3	43.2	31.8	31.0	30.1	28.4	
Scenario with key variables at their historical averages 5/						10-Year Historical Average	10-Year Standard Deviation	108.2	111.4	114.6	118.9	125.6	131.7	7.1
Key macroeconomic assumptions underlying baseline														
Real GDP growth (percent)	0.0	-6.6	-9.8	2.4	2.5	-1.8	6.5	3.3	2.7	3.0	3.1	3.2	3.3	
GDP deflator in U.S. dollars (change in percent)	2.2	-21.1	-23.8	0.2	14.8	0.5	17.5	7.8	1.3	2.5	3.7	4.1	3.5	
Nominal external interest rate (percent)	8.0	5.0	4.3	4.6	5.6	6.6	1.6	5.9	6.3	6.4	6.5	6.5	6.9	
Growth of exports of goods and services (U.S. dollar terms, percent)	-9.2	-19.9	-26.8	-4.0	17.0	1.1	24.8	6.8	2.4	5.6	2.0	6.7	7.5	
Growth of imports of goods and services (U.S. dollar terms, percent)	-6.7	-27.5	-29.0	4.7	18.9	2.6	29.0	10.8	2.9	4.3	5.9	6.3	6.4	
Current account balance, excluding interest payments	-3.2	1.5	7.8	4.3	3.5	1.5	3.7	2.1	2.7	3.3	1.6	1.8	2.5	
Net non-debt creating capital inflows	2.9	-0.1	3.5	3.6	2.1	3.4	1.5	2.0	2.0	2.4	2.4	2.4	2.5	

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.

Appendix I. Letter of Intent

Kyiv, December 5, 2018

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

Dear Madame Lagarde:

1. Since the deep economic crisis of 2014-15, with strong support from the international community, we have been able to make considerable progress in stabilizing the economy and restoring growth by beginning to address key macroeconomic imbalances and advancing structural reforms. Notably, a drastic fiscal consolidation and the adoption of a flexible exchange rate regime have led to a sharp reduction in Ukraine's twin deficits. The overall fiscal deficit—including the energy sector's quasi-fiscal deficit—which had swelled to 10 percent of GDP in 2014, declined to just above 2 percent of GDP last year, supported by prudent fiscal policies and needed increases in energy tariffs in 2015 and 2016. Similarly, the current account deficit fell sharply from over 9 percent of GDP in 2013 to 2 percent of GDP last year. Inflation has declined to single digits and official reserves have reached nearly US$17 billion. These results reflect our commitment to sound economic policies consistent with the targets under our arrangement under the IMF's Extended Fund Facility that had been approved in March 2015.

2. Structural reforms—needed to complete the transformation to a modern and open market economy—have proven to be more challenging. Considerable progress has been made in the last few years in strengthening the financial health of our banking system and in creating new independent institutions to fight corruption, with the establishment of the National Anticorruption Bureau of Ukraine (NABU), the Special Anticorruption Prosecutor's Office (SAPO), and more recently with the adoption of legislation to set up a High Anticorruption Court (HACC). Similarly, we have adopted pension reform legislation, to enhance the financial viability of the pension system, while allowing payment of better pensions, as well as a new privatization law to substantially streamline the privatization processes. Despite these achievements, several areas of reforms have faced delays. Privatization and revenue administration reform are just starting, deregulation, energy sector reforms and improving governance of state-owned enterprises are underway but have yet to be completed, while land reform is still at the stage of public debate. Because of these delays, some of the goals of the EFF arrangement are no longer attainable before its expiration in Mach 2019.

3. Nonetheless, we greatly value the continued support from the IMF and hereby request a 14-month Stand-By Arrangement (SBA) in the amount of SDR 2.8 billion (139.2 percent of quota) to succeed the EFF arrangement. The SBA will build upon progress made under the EFF arrangement and continue to provide a valuable anchor for our economic policies during 2019—a particularly challenging year as it includes two major elections and with the formation of a new government not expected before the end of 2019. The new arrangement will also continue to play a catalytic role in mobilizing international support, notably from the EU and the World Bank, which have committed additional funds to help ensure that the proposed program is fully financed.

4. The SBA will focus primarily on maintaining macroeconomic stability and keeping the economy on a path toward sustainable growth. It will focus on: (i) continuing with fiscal consolidation to keep public debt on a steady downward path; (ii) maintaining a flexible exchange rate and a tight monetary stance to bring inflation down toward the National Bank of Ukraine's medium-term inflation target and allow a further accumulation of international reserves; and (iii) reforms to further strengthen tax administration, the financial sector and the energy sector, as well as continue to improve governance and address corruption. The attached Memorandum of Economic and Financial Policies (MEFP) sets out our economic policies for the remainder of 2018 and for 2019 in greater detail. The program will be monitored through semi-annual reviews, and Table 1 of the attached MEFP presents the quantitative conditions (periodic and continuous performance criteria, indicative targets) and a monetary policy consultation clause, while Table 2 describes the structural benchmarks under the program.

5. In line with our focus, we have already taken the following prior actions:

- We have enacted a government budget for 2019, together with the necessary tax policy changes and consistent with IMF staff recommendations, that limits the budget deficit to 2.3 percent of GDP (paragraph 5b of the attached MEFP);
- Household gas tariffs have been raised, and heating tariffs will have been raised at least one week before consideration by the IMF Executive Board of our request, to reflect rising international prices and we have adopted a path for further tariff adjustment next year (paragraph 8a of the attached MEFP); and
- We have enacted legislation to improve the governance of state-owned banks (paragraph 9 of the attached MEFP).

6. Based on these steps and our commitments for the period ahead, we request approval by the IMF Executive Board of the proposed SBA and notify our decision to the cancel immediately prior to such approval the EFF arrangement. We also request that the IMF Executive Board approves to make available SDR 1 billion (49.7 percent of quota) upon approval of the arrangement. We furthermore request approval of the retention of the exchange restrictions and multiple currency practices that we maintain temporarily due to balance of payments difficulties and that are inconsistent with our obligations under Article VIII Sections 2 (a) and 3 of the Fund's Articles of Agreement. During the period of the SBA, Ukraine will not introduce or intensify exchange restrictions, introduce or modify multiple currency practices, and will not introduce or intensify import restrictions for balance of payments reasons nor conclude bilateral payment agreements that are inconsistent with article VIII of the Fund's Articles of Agreement

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 become appropriate for this purpose. We will consult in advance with the IMF on the adoption of these measures and on any revisions to the policies contained in the MEFP, in accordance with the IMF's policies on such consultation. We will refrain from policies that would be inconsistent with the program's objectives. In particular, we will refrain from granting any tax amnesty, introducing new tax exemptions or privileges, and reducing or altering corporate income taxation (CIT) directly or indirectly by replacing the CIT regime, but will explore together with IMF staff ways to make our tax system more growth friendly while assuring debt sustainability. 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 (TMU), and the accompanying Executive Board documents immediately upon consideration of our requests by the IMF's Executive Board.

Yours sincerely,

/s/	/s/
Petro Poroshenko President	Volodymyr Groysman Prime Minister
/s/	/s/
Oksana Markarova Minister of Finance	Yakiv Smoliy Governor, National Bank of Ukraine

Attachment I. Memorandum of Economic and Financial Policies

December 5, 2018

1. **Our policies remain focused on maintaining macroeconomic stability, reducing vulnerabilities, and achieving stronger and inclusive economic growth.** We are committed to preserving the achievements realized since the economic crises of 2014–15. Our policies are centered on: (i) maintaining a cautious monetary policy geared toward further reducing inflation and rebuilding reserves in the context of a flexible exchange rate regime, while repairing viable banks and reviving sound bank lending; (ii) durable fiscal consolidation to ensure medium-term debt sustainability, supported by broader fiscal reforms to make the tax system more efficient and growth friendly, and improve the quality and efficiency of government spending; and (iii) continuing with structural reforms to reform the large state-owned enterprise (SOE) sector, improving the business environment and tackling corruption, to attract investment and raise the economy's potential.

A. Monetary and Exchange Rate Policies

2. **We remain fully committed to an institutionally strong and independent National Bank of Ukraine (NBU)** that preserves continuity in its inflation targeting (IT) policy, within a flexible exchange rate regime, and with a strong focus on maintaining financial stability. We will ensure that this framework remains unchanged.

3. **Our monetary and exchange rate policies will remain consistent with our commitment to meet the program's international reserve and inflation objectives.** We intend to bring inflation down to below 7 percent by end-2019 and within the NBU's target range of 5 percent +/-1 percentage points in 2020, while letting the exchange rate adjust in line with economic fundamentals and purchasing foreign exchange to meet the program's reserve targets. Progress in reducing inflation will be monitored under the program by consultation bands around the central points of our inflation targets (Table 1); if actual inflation falls outside the inner band, the NBU will consult with IMF staff on the reasons for the deviation and policies to return inflation to within the band. To achieve our inflation targets, the NBU will continue to keep its policy rate firmly positive in real terms on a forward-looking basis. The NBU stands ready to raise the policy rate if inflation pressures threaten the disinflation path projected in the program. Any further easing of foreign exchange restrictions and administrative controls will be aligned with the agreed roadmap's principles and conditions that, inter alia, require steps to be consistent with meeting the program's

reserve targets. Additionally, the gradual capital control liberalization envisaged in the new currency law will be carefully sequenced and conditions-based, without setting specific deadlines for the removal of existing restrictions.

4. We will take further steps to strengthen the effectiveness of monetary policy and support the development of financial markets. To enhance the monetary transmission mechanism, the NBU, in consultation with IMF staff, will adjust its operational framework to make it applicable to varying structural liquidity conditions. In this context, the Ministry of Finance will provide the NBU with enhanced daily and monthly cash flow projections of the Single Treasury Account, as needed for improved liquidity forecasting.

B. Fiscal Policies

5. Fiscal policy in 2018 and 2019 will continue to be anchored by our medium-term consolidation path aimed at ensuring fiscal sustainability. We will limit the general government budget deficit to no more than 2½ percent of GDP in 2018 and 2¼ percent of GDP in 2019. More specifically:

a. ***2018 Budget.*** While budget execution is so far broadly in line with the approved budget, spending pressures are expected to increase in the coming months stemming primarily from higher than envisaged social spending (including pensions and utility subsidies). We will ensure compliance with the deficit target of 2½ percent of GDP, by strictly curtailing discretionary spending, notably spending on goods and services but also by deferring some capital spending, raising additional excise revenues on tobacco products according to the current schedule of increases; and additional profit transfers from state-owned enterprises. The Ministry of Finance will not release any resources to spending units that would cause the deficit to exceed the target and inform all spending units of the changes to the payment schedule.

b. ***2019 Budget.*** The general government budget deficit will be limited to UAH 90 billion, equivalent to 2¼ percent of GDP, with revenues in the State budget estimated at UAH 1,026 billion and spending budgeted at UAH 1,116 billion. The budget includes no major changes in tax policy, other than the already scheduled increases in excise rates plus a further increase in the excise on tobacco products by 9 percent effective from July 1, 2019;

an increase in the rates of royalty payments for hydrocarbons (oil extraction and gas condensate extraction) by 2 percentage points and for iron ores by 0.8 percentage points; an increase in the royalty payment for forestry usage by 2 percentage points; an increase in the environmental tax rate for carbon dioxide (CO^2) emissions by stationary sources from UAH 0.41 per ton to UAH 10 per ton; a reduction of the threshold for VAT exemption for parcels sent through international express shipment from €150 to €100; the introduction of customs duties of US$1,000 on imported cars with foreign registration; and the introduction of electronic excise stamps. To create sufficient fiscal space for security-related spending and much-needed investment in infrastructure, civil service wages are kept at their 2018 level and the average wage increase for public sector employees is limited to 9.4 percent in 2019, while the minimum monthly wage was raised by 12 percent to UAH 4,173. Similarly, pension benefits, including for military and other special pension schemes, will increase on average by 8½ percent in accordance with the pension reform law adopted in 2017. To rationalize our health care expenditures, in 2019 the Ministry of Health will continue to outsource the procurement of pharmaceuticals to reputable international organizations. We have taken steps to further improve the targeting of housing and utility subsidies to ensure that these will remain within the budgeted amount, including by reducing the social norms for the calculation of housing and utility subsidies on average by 11 percent (including by reducing the amount of the subsidized gas consumption from 4.5 cubic meters to 4.0 cubic meters per one square meter of heated space and a commensurate reduction in the norm for centralized heating, effective May 1, 2019). Parliamentary approval and enactment of this budget is a ***prior action***. In early 2019, we will remove the caps on the base for social security contribution assessments. If during 2019 it becomes evident that the reduction in the social norms is not sufficient to ensure that housing and utility subsidies will remain within the budgeted amount, we will further reduce these norms or make the necessary changes to the formula for the calculation of subsidies.

c. During the program period we will refrain from: (i) granting any tax amnesty, introducing new tax exemptions or privileges, and further earmarking of revenues; (ii) reducing or altering corporate income taxation (CIT) directly or indirectly by replacing the CIT regime; (iii) introducing new special pensions or privileges; and (iii) introducing (elements of) a funded second pillar to the pension system. We will continue to work with IMF staff to develop proposals to improve corporate taxation and make the tax system more growth friendly, including by addressing tax gaps, broadening the tax base, and reducing opportunities for tax avoidance, but will not enact any legislation during the program period that changes our tax system such that it will undermine fiscal sustainability. Any revenue over-performance will be used to reduce public debt, settle arrears, or increase infrastructure investment. We will remain current on all our payment obligations and not accumulate any spending arrears. We will review the revenue sharing and expenditure assignment responsibilities between the central and local government budgets to avoid the accumulation of subnational imbalances.

Public Financial Management

6. **We will continue to strengthen our fiscal framework to facilitate sustainable fiscal adjustment and improve the credibility and predictability of fiscal policies.** As part of our Public Financial Strategy for 2017–2021, we are fully committed to implement a full-fledged medium-term budget framework (MTBF) for the 2019 budget year. Adhering to the MTBF will reinforce fiscal discipline and facilitate informed policymaking, better monitor expenditure commitments, and provide predictability in planning and executing budgets. To this end, we will: (i) amend the budget code to reflect core elements of the MTBF in line with IMF recommendations, establish the mandate for fiscal risk monitoring and reporting, and strengthen debt management by requiring a credit risk assessment for issuing government guarantees; (ii) introduce binding budget ceilings for key spending units in the annual budget declaration; and (iii) regularize assessments of public expenditure efficiency through rolling spending reviews. In this context, we will seek technical assistance from the IMF to further strengthen the MTBF by adopting a rule-based fiscal policy framework, in line with best international practices, to avoid procyclical behavior and anchor public debt sustainability.

Revenue Administration

7. **We are taking steps to move toward modern and efficient tax and customs administrations.** As progress in revenue administration reform had met with several obstacles in recent years, to achieve our objectives:

a. ***Organization.*** We will consolidate the current central and regional units of the State Fiscal Service (SFS) into two separate legal entities: the Tax Service and the Customs Service by end-April 2019, which will both report to the Minister of Finance (a ***structural benchmark***). The many current legal entities comprising the SFS will be abolished as part of this process. This will be the first, and essential, foundational step on the roadmap to long-term reform of revenue administration. The heads of both services will be able to delegate their powers in the organizations as needed for the more efficient functioning of tax and customs administrations. By the same time, the tax police will be transformed into a new financial investigation service under the Ministry of Finance, in line with technical advice from the IMF, while ensuring that assessment of tax liabilities remains solely with the Tax Service.

b. ***Management.*** We will ensure that an effective and reform-oriented management for both the tax and customs administrations will be appointed through a transparent recruitment process by end-April 2019. The new managers will be tasked with developing and implementing transformational improvement of operations in both organizations, which include reforming tax audit and verification practices and introducing new approaches in addressing tax non-compliance. The new agency heads should present within one month following their appointments transformational reform plans to the Minister of Finance. The plan for the tax administration will be guided by the roadmap suggested by the IMF's technical assistance report of September 2017.

c. ***Oversight.*** We will increase the Ministry of Finance's role in the oversight of the tax and customs administrations by strengthening its supervision and control functions. We will also develop detailed reporting requirements for the tax and customs administrations and the methodology for calculating KPIs to enable the Ministry of Finance to verify and better assess KPIs, including indicators related to anti-corruption efforts in both organizations. As part of monitoring the effectiveness of the managements in tax and customs services, by end-December 2018 the Ministry of Finance will begin conducting annual independent surveys of taxpayers to assess their perception of corruption at tax and customs administrations. The Ministry of Finance will also complete an audit of the tax and customs administrations' IT systems to detect weaknesses and risks for data security in the tax and customs systems by end-December 2018. Based on the audit results, the necessary steps to address any security threats will be implemented by March 2019.

d. ***Tax and customs processes.*** We are also taking measures to improve the efficiency of the tax and customs administrations. We will alleviate the burden that taxpayers face to comply with their tax obligations by: (i) rebalancing the audit program away from mandatory audits (such as liquidation audits and audits at the request of other agencies) towards targeted audits based entirely on assessed compliance risks; (ii) enhancing the online taxpayer portal (e-cabinet) to allow for online registration, electronic payment for businesses and updating of taxpayer information; and (iii) improving taxpayers information services. In customs, we have established a one-stop process for clearance, and are continuing efforts to fight fraud and corruption, facilitate the information exchange with major trading partners and build an effective oversight of and support to the valuation field work of the regional offices.

C. Energy Policies

8. We will continue our efforts to advance gas sector reforms. Specifically:

a. ***Gas and heating tariffs.*** We have (i) raised the wholesale price for gas supplied to households and district heating companies to UAH 6,236 per thousand cubic meters (excluding transmission and distribution tariffs, supplier's mark-up and VAT), effective November 1, 2018; (ii) revised the automatic gas price adjustment mechanism to ensure that the wholesale price for gas supplied to households and for heating will be adjusted automatically effective May 1, 2019 to 80 percent of the base market price as defined in CMU Resolution 867 (as defined also in paragraph 25 of the TMU); and (iii) the National Energy and Utilities Regulatory Commission (NEURC) has given final approval to—and published in the official gazette—increases in the heating tariffs, effective January 1, 2019, to fully reflect the increase in the wholesale gas price, of all the heating companies licensed by NEURC together accounting for about 60 percent of the total centralized heating supply (a ***prior action***). The necessary decisions for raising heating tariffs, effective January 1, 2019, to reflect the higher wholesale gas price, of remaining heating companies —thus together covering at least 95 percent of the total centralized heating supply—are expected to be taken by end-December 2018 (a ***structural benchmark***). As of January 1, 2020, Naftogaz will sell gas for household and district heating companies' use at prevailing market prices and the Public Service Orders will be cancelled by May 1, 2020. We have cancelled the scheme that allowed a 12-month installment plan to pay heating bills for households that do not receive subsidies (CMU Resolutions 630 and 357).

b. ***Monetization.*** We are working with the World Bank to gradually monetize the benefits of the HUS program to facilitate retail market competition and incentivize households to reduce gas consumption. As a preparation for the monetization of subsidies the Ministry of Social Policy has already created the public registry of utility subsidy recipients and the Ministry of Finance and the Ministry of Social Policy will complete the verification of recipients of all social benefits and allowances by end-December 2018. In March 2019, a pilot project of monetization of subsidies will be launched. Upon a successful trial period, we aim to implement the monetization of subsidies at end-user level starting from January 2020. Additionally, starting from July 2019, we will set up an Energy Efficiency Fund to help facilitate the decrease in gas consumption in Ukraine.

c. ***Unbundling.*** The unbundling of Naftogaz and certification of a Transmission System Operator (TSO) is a key strategic issue for advancing energy sector reforms. The establishment of Mahistralni Gazoprovody Ukrayiny (MGU) as a certifiable TSO on January 1, 2020 requires transfer of selected activities and staff from Naftogaz (UTG) to MGU. As result of the Stockholm arbitration, only non-core transit activities can be transferred from Naftogaz to MGU until the end of 2019, and core transit activities can be transferred after January 1, 2020. To start the transfer, Naftogaz will prepare the list of non-core transit activities by December 31, 2018 and these will be transferred to MGU during 2019. The selection will prioritize activities which are not yet fully established in UTG, such as metering and market balancing operations, network development, and planning. It is expected that MGU will reach its target staffing level of about 4000 and meet all preconditions for certification as a TSO by end-September 2019.

d. ***Gas production.*** To increase gas production and help ensure energy independence, we will simplify and accelerate procedures for obtaining permits for the exploration and development of gas fields, while ensuring transparency, inter alia by holding open permit and production sharing agreement tenders at least of a quarterly basis, offering at least 20,000 km^2 during 2019. We will also promote investment in existing fields to increase extraction, while ensuring compliance with environmental standards.

D. Financial Sector Policies

9. Since 2014, we have taken major steps to rehabilitate and strengthen the banking system. We have intervened and resolved 95 banks (out of 180 in 2014), including PrivatBank, the largest financial institution. In addition, a few banks excessively exposed to related-party lending have made progress in reducing such exposures. As a result of these efforts, as of end-July 2018, all banks met the capital adequacy ratio (CAR) target of 7 percent. Furthermore, we have made progress in strengthening our supervisory and regulatory framework, including our credit risk regulation by reversing amendments to Regulation 351 lowering the loss-given-default ratio for the calculation of credit risk for state-owned enterprises and automatically removing provisioning on restructured loans, with the view to bringing them closer to international standards and best practices. Importantly, we have improved state-owned banks' governance by adopting the Principles of State Banking Sector Strategic Reforms and enacting a law on State-Owned Bank Corporate Governance (a ***prior action***).

10. We remain fully committed to further strengthening the banking system's financial health. To this end:

a. ***Capitalization.*** On the basis of the 2018 diagnostic study, by end-March 2019, all banks will have to meet a minimum 7 percent Tier 1 capital and 10 percent CAR. In the context of the transition to Basel III capital structure requirements, we will allow banks to include in Tier 1 capital additional Tier 1 (AT1) up to 0.75 percent; as such, Tier 1 capital will consist of at least 6.25 percent of common equity. In the computation of their capital needs, the largest 24 banks will also address capital needs arising from the 2018 stress testing, under the baseline scenario for 2018 only (these banks will have until end-2019 to address potential capital needs under the adverse scenario and their restructuring plans will fully address the effects of amortization of collateral against NPLs in line with the requirements of resolution 351). When banks that fail to comply with requirements under the baseline scenario, the NBU will take appropriate supervisory actions, including resolution, by end-June 2019 (a ***structural benchmark***). Furthermore, by end-March 2019, the NBU will complete its viability assessment of the smallest 56 banks' business models. This evaluation process will be conducted by the NBU Committee of Supervision, with the participation of IMF and World Bank staff as observers.

b. ***Related-party exposures.*** By end-December 2018, the NBU will publish amendments to the existing regulation on related-party exposures that incorporates lessons learned from the implementation of the current regulation over the last 3 years. Additionally, by the same date, the NBU will adopt revisions to its capital regulations to subtract loan exposures to related parties above regulatory limits from regulatory capital (an end-December 2018 ***structural benchmark***). Furthermore, with IMF technical assistance, we will further enhance the effectiveness of the Related Party Monitoring Office (RPMO) by developing a data registry based on information from public registries, for which by end-December 2018 the NBU will sign a Memorandum of Understanding with the Ministry of Justice and the Securities Market Authority on information sharing, which is critical to build such registry.

c. ***Deposit Guarantee Fund (DGF).*** As a well-capitalized and funded deposit insurance system is critical for financial stability, we have set up a tripartite working group (comprised of representatives of the Ministry of Finance, the NBU and the DGF) to submit specific measures to the Financial Stability Council (FSC). In consultation with staff of the IMF and the World Bank, the FSC will decide by end-March 2019 on steps to bring the DGF back into solvency by end-December 2019. Finally, we will pursue parliamentary approval by end-March 2019 of draft amendments to the DGF law that aims at strengthening its effectiveness as resolution authority. Meanwhile the NBU and the DGF will timely share information.

d. ***Supervision and regulation.*** By end-December 2018, in the context of the transition to Basel III capital structure requirements and in consultation with IMF and World Bank staff, the NBU will approve a resolution on the use of additional Tier 1 capital instruments (AT1) to meet Tier 1 capital for the current recapitalization process, including minimum triggers, limits and full adaptation of Basel III's terms and conditions. Additionally, we will complete the assessment of the collective suitability of the boards and qualifications of senior management for the 20 largest banks by end-December 2018, for the next 15 largest banks by end-September 2019, for the next 15 largest banks by end-December 2019, and with the remaining banks to be assessed in 2020. Furthermore, we will verify compliance with the new risk management regulation for the 30 largest banks according to the schedule of implementation of the regulation. Furthermore, we will adopt the Supervisory Review and Evaluation Process (SREP), except for ICAAP and ILAAP, for the 13 largest banks by end-

2018, and for all banks by end-June 2019. By end-December 2018, we also plan to complete and introduce the new regulation on banks' registration and licensing (replacing NBU Regulation No. 306). By end-December 2018, we also plan to complete the draft new regulation on internal control, which we will introduce as of July 1, 2019.

11. We are determined to recover assets from resolved banks to reduce the cost of bank failures to the state. To this end, we will ensure that all relevant institutions will pursue all commercial and legal avenues available to recover assets and hold banks' former owners accountable as envisaged by the banking law. As such, beginning by end-March 2019, the DGF will post on its website a list of all borrowers, management, and former bank shareholders of resolved banks that are yet to honor their debts related to the failed institutions as ruled by court decisions. By end-March 2019, the DGF will put on sales assets for at least UAH 20 billion. The DGF will continue selling assets through electronic platforms, while ensuring that the ultimate buyers of defaulted related party loans and the bank owners are not the same person. Additionally, the Ministry of Finance will produce regular reporting summarizing progress in asset recovery and litigation efforts related to the four state-owned banks, with the first report to be published by end-March 2019 (a ***structural benchmark***).

12. We are taking further steps to facilitate NPL resolution. Following the establishment of a mechanism for out-of-court restructuring, the removal of tax impediments and the adoption of the law on creditors' rights protection, parliament also adopted a new insolvency law (# 8060). In addition, by end-June 2019, the NBU, with the support from World Bank staff, will issue a regulation on NPL work-out to guide the financial institutions on how to deal with their troubled borrowers. This regulation will be in line with best practices and the European Central Bank's guidance to banks on NPLs, while taking into account local structural issues such as large credit exposure to related parties in banks. With respect to the stock of NPLs held by our three SOBs (OschadBank, UkrGazBank, and UkrEximBank), we are taking decisive steps: (i) in September 2018, under the auspices of the FSC, we have established a working group comprised of the Ministry of Finance, the NBU, and the DGF to prepare, in consultation with IMF staff, policy principles to guide the restructuring of these troubled borrowers. These policy principles will be in line with the legislation on joint stock companies with regard to the respective responsibilities of corporate governance bodies regarding significant restructuring decisions and include, *inter alia,* recommendations to the state-owned banks' supervisory boards. By end-December 2018, the FSC will approve these principles and communicate them to the above-mentioned state-owned banks' supervisory boards, which ultimately remain responsible for these banks' debt restructuring decisions.

13. We will further strengthen bank governance, transparency and risk management practices of the state-owned banks. In this direction:

a. Following the adoption of the law on state-owned banks, we will appoint independent supervisory board members in line with the new law in OschadBank and UkrEximBank (following the establishment of majority independent supervisory boards at PrivatBank and UkrGasBank) by end-March 2019.

b. By end-April 2019, the Ministry of Finance will sign a Memorandum of Understanding with each state-owned bank defining the boundaries of their relationship with the view to ensuring that these banks are run on a commercial basis and isolated from political interference on operational matters.

c. From end-December 2018 onward, the financial unit of the Ministry of Finance will publish quarterly Key Performance Indicators (KPIs) of the state-owned banks and also report on progress made in the implementation of their strategic planning and NPL restructuring.

d. Consistent with the Principles of State Banking Sector Strategic Reforms, we will take the necessary steps to pave the way for the entry of EBRD and IFC into the capital of OschadBank and UkrGasBank, respectively. In this context, we will also aim to unwind the current full state guarantee of Oschadbank's deposits by end-December 2019.

14. Additionally, we will move forward with legislation that is critical to create a sound operating environment for the development of our financial markets. To this end:

a. By end-March 2019, we expect parliament to adopt the law revisiting the supervisory responsibility for a variety of financial intermediaries ("split" law; #2413a; a ***structural benchmark***) and legislation establishing the powers, independence and institutional capacity of the National Securities and Stock Market Commission, allowing it to meet IOSCO standards (# 6303).

b. By end-March 2019, in coordination with the IMF and World Bank staff, we will submit amendments to the Law on Banks and Banking to address legal loopholes identified after the assessment of our regulatory and supervisory framework for sound risk governance practices against the 2015 Basel's Guidelines for Corporate Governance for banks.

c. Finally, we will work toward the adoption by mid-2019 of several financial sector laws under consideration by the Parliament, notably laws on derivatives and financial markets, consumer protection and money transfers.

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

Anticorruption

15. We are committed to build on recent gains in our efforts to tackle high-level corruption and to deliver concrete results. It is critical that the new anticorruption institutions—the National Anticorruption Bureau of Ukraine (NABU), the Special Anticorruption Prosecutor's Office (SAPO), and the High Anti-Corruption Court (HACC)—maintain their independence and integrity, to ensure that high-level corruption cases are effectively and credibly investigated, prosecuted, and adjudicated. We will make every effort to ensure the independence and integrity of these institutions and address shortcomings in the asset declaration and AML/CFT frameworks:

a. ***Anticorruption court***. We will operationalize the High Anti-Corruption Court (HACC) as established under Law 2018/2447, to ensure that corruption cases are adjudicated by judges with specialized skills and high integrity. The six members of the Public Council of International Experts (PCIE) have been appointed by the High Qualification Commission of Judges (HQCJ) from the nominations submitted by international organizations according to the criteria established in the Law. We will ensure that the entire process for assessing the candidates' practical skills and integrity, and their selection is transparent and consistent with the Law on the Judiciary and the Law on the HACC, including that the qualification evaluation is centered on anonymous written tests and a case study, and with publication of the methodology for assessment, the criteria used for the qualification evaluation, and the grades received by candidates for each test. The members of the PCIE and the HQCJ are provided, bound by confidentiality and sufficiently ahead of any interviews and assessments, with the same access to information on candidates. By end-April 2019, following nomination by the High Council of Justice, at least thirty-five anti-corruption judges with impeccable reputation and relevant professional skills will be appointed to the HACC in line with law

2018/2447, and with rules of procedures guaranteeing the objectivity and transparency of the process (a ***structural benchmark***). We expect the HACC to begin its operations by end-June 2019, and we will ensure that it has adequate resources for its operations, including staffing and IT, and that security is provided for buildings and personnel, as well as that all pending corruption cases subject to the HACC's jurisdiction are transferred from the other courts in accordance with the law.

b. ***National Anticorruption Bureau of Ukraine (NABU) operations***. In line with the prior action implemented in the context of the approval of the arrangement under the IMF's Extended Fund Facility in March 2015, an external audit of the NABU will be conducted by a panel of respected experts with international experience selected in accordance with the requirements set out in the NABU Law (#1698-VII). The terms of reference for the external audit of NABU will be developed in consultation with IMF staff and we will ensure that auditors have adequate resources to efficiently and independently complete the audit of NABU in time. Based on the analysis conducted by the auditors, the audit report will include clear and prioritized recommendations on the effectiveness of NABU and its operational and institutional independence, in line with international best practices. In case the auditors unanimously conclude that the criteria on dismissal of the NABU director referred to in Article 6.4.11 of the NABU Law are met, they will include the evidentiary basis, a detailed rationale, and recommendation in their report. In line with this framework, an audit report will be finalized by end-July 2019 and appended to the subsequent NABU report (a ***structural benchmark***). By end-June 2019, parliament will adopt legislation to strengthen the powers of NABU to ensure that the NABU has 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. We will maintain NABU's exclusive authority to investigate acts of corruption by high-level officials.

c. ***E-declaration***. Ensuring that politically exposed persons (PEPs) remain subject to comprehensive and published asset declaration requirements remains a priority, as this is critical to effectively address illicit enrichment and prevent the laundering of the proceeds of corruption. In this regard, by end-December 2018: (i) the National Agency for the Prevention of Corruption (NAPC) will ensure that NABU has direct and secure electronic access to the full asset declarations of all persons under NABU investigative jurisdictions; (ii) the NAPC will revise the electronic declaration form to facilitate the identification of PEPs, by ensuring an online search criteria for PEPs and the publication of the PEP's year and month of birth; (iii) the NAPC will start publishing quarterly statistics to monitor progress made in detecting absence or false declarations on a webpage freely available to the public (in line with the template detailed in paragraph 94 of the TMU); and (iv) the Ministry of Justice will prepare, in consultation with the relevant authorities, including the NAPC and NABU, a study on the legal and practical steps needed to transfer responsibility for the verification of asset declarations of persons under NABU's jurisdiction to NABU.

d. ***AML implementation***. We remain committed to strengthening and mobilizing the AML/CFT framework to support efforts to tackle high-level corruption. In this respect, by end-March 2019, and in agreement with IMF staff, we will adopt amendments to the AML legal framework, including to ensure: (i) the implementation of a three-tier reporting system (suspicious transaction reports as defined by the FATF, threshold-based reporting of cash transactions and international funds transfers, and mandatory reporting of transactions related to high-risk jurisdictions and PEPs); (ii) that the definition of the persons related to PEPs is consistent with the risk-based approach encouraged by the FATF standard; (iii) that proportionate and dissuasive sanctions can be implemented by the NBU in case of breaches of compliance with the AML framework, and (iv) that information on beneficial owners of companies is up-to-date and accurate. 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 96 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, including with regard to requirements to identify PEPs, to verify their source of wealth and beneficial ownership information. By end-January 2019, the NBU, with technical assistance from the IMF, will also prepare a roadmap to focus AML/CFT supervision on ensuring the adequacy of financial institutions' AML/CFT framework, and discontinue investigative functions.

Privatization and State-Owned Enterprise Reform

16. We remain committed to our SOE-reform strategy, that focuses on significantly downsizing the state-owned enterprise sector. Key measures include:

a. ***Privatization***. We have enacted a new privatization law, and the CMU has adopted the triage of all SOEs. We have now started the preparations for the sale in line with international best practices of six large SOEs, with the assistance of reputable advisors, and by end-December 2018 will launch the tender for the sale of PJSC Centrenergo. This will be followed by tenders for sale of Coal Company Krasnolymanska, Indar, and the President Hotel Kiev in the first half of 2019. We have also started with the sale of small companies and assets through electronic auctions (ProZorro), with the objective to have at least 500 small companies and assets sold by end-April 2019. We will submit draft legislation to parliament by end-April 2019, to reduce the list of companies banned from privatization to ensure that it is limited only to enterprises that are essential for national security. We will adopt a new law on the leasing of state property as a step to generate further demand for public assets by private entities. We will continue with our efforts to adopt a new bankable concessional law and launch a concession pilots in the first half of 2019.

b. ***SOE governance.*** We expect parliament to adopt the law on SOE governance (draft bill # 6428) by [end-June 2019], clarifying and strengthening the powers of supervisory boards and granting legal immunity and indemnity to its members. The selection of majority-independent supervisory boards for the largest SOEs, including Ukrenergo, Boryspil, Ukrposhta, is expected to be completed by end-December 2018. Moreover, external audits of the largest SOEs (prepared by international reputable companies) will be conducted by end-December 2019.

c. ***Oversight of SOEs fiscal risks***. Monitoring and assessment of fiscal risks emanating from the SOE sector will be one of the key responsibilities of the recently-established fiscal risks management division in the Ministry of Finance. We will also introduce a comprehensive fiscal risk management system and adopt the necessary legislative changes by end-July 2019 to better manage and reduce fiscal risks and enhance public asset and debt management (including public guarantees, public private partnerships, and local government borrowing).

Business Climate and Markets

17. ***Deregulation.*** In the last two years, we have substantially streamlined our regulatory framework *inter alia* by reviewing and abolishing about 700 obsolete and non-relevant sub-legislative acts, the automation of state supervision (control), streamlining procedures for obtaining permits and licenses, improving clarity and transparency in construction, telecom, and natural resources. We will continue to further review and streamline sub-legislation, reduce time for land allocation, simplify access to geological information, improve the system of subsoil use right auctions, implement risk-based approaches to audits and inspections by state authorities, simplify cash registers usage (by introducing new technologies and widening possibilities for cashless transactions, and impose sanctions for violating cash turnover regulations.

18. ***Land market.*** We will continue our preparations for establishing a transparent market for agricultural land. A working group comprising relevant ministries, in collaboration with the World Bank, has drafted a land turnover law to allow for the sale of land under adequate safeguards, and we have launched a public information campaign to explain the benefits of this reform.

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

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

	2017	2018	2019	2019	2019	2019
	December	December	March	June	September	December
	Act.	IT	PC	IT	PC	IT
I. Quantitative performance criteria						
Ceiling on the cash deficit of the general government (- implies a surplus) 2/	-	86,168	35,000	50,000	75,000	90,071
Ceiling on the cash deficit of the general government and Naftogaz (- implies a surplus) 2/	-	86,168	35,000	50,000	75,000	90,071
Floor on cumulative change in net international reserves (in millions of U.S. dollars) 3/ 4/	6,691	1,218	1,229	1,955	334	893
Ceiling on publicly guaranteed debt 2/	-	15,000	20,000	20,000	20,000	20,000
II. Continuous performance criterion						
Non-accumulation of new external debt payments arrears by the general government 4/	-	0	0	0	0	0
III. MPCC						
Inflation target 5/	-	6.0	5.75	5.5	5.25	5.0
IV. Indicative Targets						
Ceiling on cumulative change in net domestic assets of the NBU 3/	209,845	16,865	6,225	8,952	51,795	64,269
Ceiling on stock of VAT refund and CIT prepayment arrears 6/	-	0	0	0	0	0
Ceiling on current primary expenditure of the state budget and social funds 2/ 7/	-	1,118,520	n.a.	n.a.	n.a.	1,253,870
V. Memorandum Items						
Naftogaz deficit (- implies a surplus) 2/	-	0				0
External project financing 2/	-	17,000	5,000	10,000	15,000	21,161
Government bonds issued for banks recapitalization and DGF financing 3/	-	0	14,000	14,000	14,000	14,000
Programmed disbursements of international assistance except IMF (millions of U.S. dollars) 3/ 4/	-	3,297	4,297	5,882	5,882	6,882
Use of swaps (exchange of deposits) with other central banks 3/ 4/	-	0	0	0	0	0
Net issuance of central government domestic FX debt 3/ 4/	-	-30	-312	-356	-419	-479
Use of confiscated assets for FX payments or transfer to NBU gross international reserves 3/ 4/	-	0	0	0	0	0
Net new NBU loans to DGF and operations with government bonds issued for DGF financing or banks recapitalization (net of repayments to NBU) 3/	-	-9,384	-10,984	-10,984	-10,984	-10,984
Program accounting exchange rate, hryvnia per U.S. dollar	28.2794	28.2794	28.2794	28.2794	28.2794	28.2794

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

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

2/ Targets and projections for 2018 are cumulative flows from January 1, 2018. Targets and projections for 2019 are cumulative flows from January 1, 2019.

3/ Targets and projections are cumulative from January 1, 2018. Data for December 2017 are stocks for end-December 2017.

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

5/ End of period, year-on-year headline inflation. Outer consultation band, triggering consultation with the Board, will be +4.75/-3.5 percentage for March 2019 and September 2019. Inner consultation bands, triggering consultation with staff, will be +/- 2 percentage points for December 2018, March 2019, June 2019 and September 2019 and +/- 1 percentage point for December 2019.

6/ For 2018 includes the stock of CIT prepayment arrears.

7/ For 2018, includes the consolidated pension and social funds.

Table 2. Ukraine: Prior Actions and Structural Benchmarks

Prior actions	**Status**	**Completion date**
1. Parliamentary approval and enactment of the 2019 budget and supporting tax legislation consistent with the program target of 2.3 percent of GDP (as specified in ¶5b).	Met	
2. (i) Raising the wholesale price for gas supplied to households and district heating companies to UAH 6,236 per thousand cubic meters (excluding transmission and distribution tariffs, supplier's mark-up and VAT), effective November 1, 2018; (ii) revision of the automatic gas price adjustment mechanism to ensure that the wholesale price for gas supplied to households and for heating will be adjusted automatically effective May 1, 2019 to 80 percent of the base market price as defined in CMU Resolution 867; and (iii) and approval and publication by the National Energy and Utilities Regulatory Commission (NEURC) of increases in the heating tariffs, effective January 1, 2019, to fully reflect the increase in the wholesale gas price, of all the heating companies licensed by NEURC (as specified in ¶8a).		
3. Enactment of the law on State-Owned Bank Corporate Governance (law #2491).	Met	
Proposed Structural Benchmarks		
1. Raising heating tariffs, effective January 1, 2019, to reflect the higher wholesale gas price, of all remaining heating companies with an output of up to the NEURC-set threshold for volumes of annual production and supply of heating energy—thus together covering at least 95 percent of the total centralized heating supply (as specified in ¶8a).		End-December 2018
2. Adoption by the NBU of revisions to its capital regulations to subtract loan exposures to related parties above regulatory limits from regulatory capital (as specified in ¶10b).		End-December 2018
3. Parliamentary approval of the law revisiting the supervisory responsibility for a variety of financial intermediaries ("split" law; #2413a) (as specified in ¶14a).		End-March 2019
4. Publication of first report summarizing progress in asset recovery and litigation efforts related to the four state-owned banks (as specified in ¶11).		End-March 2019
5. Consolidate the current central and regional units of the State Fiscal Service (SFS) into two separate legal entities: the Tax Service and the Customs Service by end-April 2019, which will both report to the Minister of Finance (as specified in ¶7a).		End-April 2019

Table 2. Ukraine: Prior Actions and Structural Benchmarks (concluded)	
Proposed Structural Benchmarks	
6. Following nomination by the High Council of Justice, at least thirty-five anti-corruption judges with impeccable reputation and relevant professional skills will be appointed to the HACC in line with law 2018/2447, and with rules of procedures guaranteeing the objectivity and transparency of the process (as specified in ¶15a).	End-April 2019
7. The NBU to take appropriate supervisory actions against banks that fail to comply with capital requirements (as specified in ¶10a).	End-June 2019
8. Complete an external audit of the NABU, conducted by a panel of respected experts with international experience selected in accordance with the requirements set out in the NABU Law (#1698-VII) (as specified in ¶15b).	End-July 2019

Attachment II. Technical Memorandum of Understanding

December 5, 2018

1. This Technical Memorandum of Understanding (TMU) sets out the understandings between the Ukrainian authorities and IMF staff regarding the definitions of the variables subject to quantitative targets (performance criteria and indicative targets) for the economic program supported under the Stand-By Arrangement, as described in the authorities' Letter of Intent (LOI) dated December 5, 2018 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. The quantitative performance criteria are shown in Table 1 of the MEFP. Prior actions and structural benchmarks are listed in Table 2 of the MEFP, with corresponding definitions in Section I below. 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 28.2794 set by the National Bank of Ukraine (NBU) as of August 31, 2018; and (ii) reference exchange rates of foreign currencies reported by the European Central Bank (ECB) on its web site as of August 31, 2018, which the NBU used to set official exchange rates of hryvnia to those currencies. In particular, the Swiss Franc is valued at 0.9698 per dollar, the Euro is valued at 1.1692 dollars, the Pound Sterling is valued at 1.3026 dollars, the Australian dollar is valued at 0.7301 U.S. dollars, the Canadian dollar is valued at 0.7734 dollars, the Chinese Yuan is valued at 0.1464 U.S. dollars, and the Japanese yen is valued at 111.4608 per dollar. The accounting exchange rate for the SDR will be 0.713578 per dollar. Official gold holdings were valued at 1,202.35 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, CONSULTATION CLAUSE, 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), which are not already excluded from reserve assets, but excluding foreign exchange liabilities to the general government, or related to deposit guarantees.

Table A. Ukraine: 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, 2746, minus 4746
	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
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 an average rollover of central government's domestic foreign exchange securities of at least 70 percent in 2018Q4 and 2019Q1 and 100 percent in 2019Q2-Q4.

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

The rollover will be achieved through an issuance of new central government foreign exchange securities with a maturity of at least 6 months, without options of early repayment.

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 securities over (under) the amounts expected under the baseline (see Table 1 of the MEFP).

- 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 case the NBU requests use (draws) any reserve currency provided under a central bank swap agreement with a maturity of over 1 year, a symmetric adjuster will be applied to NIR targets. NIR targets will be adjusted upward by the amount used with maturity over 1 year. NIR targets will be adjusted downward when the NBU repays these amounts.

- The NIR targets will be adjusted upward (downward) by the full amount of the cumulative excess (shortfall) from the transfer of unencumbered confiscated foreign exchange assets to international reserves at the NBU or, if not transferred to international reserves, by the use of confiscated assets held at other accounts (or any other non-international reserve accounts) to make government FX payments, over (under) the amounts expected under the baseline (see Table 1 of the MEFP).

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

(Cumulative flows from January 1, 2018, millions of U.S. dollars at program exchange rate)

	Eurobond and private placement	EU	Others	Total
End-December 2018	2,695	603	0	3,297
End-March 2019	3,695	603	0	4,297
End-June 2019	4,695	1.187	0	5,882
End-September 2019	4,695	1,187	0	5,882
End-December 2019	5,695	1,187	0	6,832

B. Ceiling on Cumulative Change in Net Domestic Assets of the NBU (Indicative Target)

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 national currency outside banks and banks' reserves, including cash at banks, and other NBU liabilities included in broad money and denominated in national currency.[2] Currency in circulation outside banks is defined as Currency—banknotes and coins (NBU accounts of group 300 minus NBU accounts of group 100)—minus cash at banks (banks' accounts of group 100. Banks' reserves are defined as cash at banks (banks' accounts of group 100) plus banks' demand deposits at the NBU in national currency (NBU liabilities accounts 3200, 3203, 3204 and 3208). Other NBU liabilities consist of deposits at the NBU that are included in broad money and denominated in national currency (NBU liabilities accounts of groups 323,[3] and accounts 3250, 4731, 4732, 4735, 4736, 4738, 4739, and 4750).

[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 national currency issue and banks' deposits at the NBU.

[3] Includes accounts of following sectors: other financial corporations;
state and local government; nonfinancial corporations; nonfinancial corporations; and non-profit institutions serving households.

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 new NBU loans (net of repayments) 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), relative to the baseline projection, and evaluated at the program exchange rates if provided in foreign exchange (Table C). The combined upward adjustment is up to a cumulative maximum of the bank recapitalization and DGF financing bonds issued from January 1, 2018 and the indicative cumulative limits are derived from the relevant row of Table 1 of the MEFP.

- The NDA targets will be adjusted downward (upward) 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 1 of the MEFP).

- The NDA targets will be adjusted downward (upward) by the full amount of the cumulative excess (shortfall) from the transfer of confiscated foreign exchange assets to international reserves at the NBU or, if not transferred to international reserves at the NBU, by the use of confiscated assets held at other institutions (or other non-international reserves assets) to make budget FX payments, over (under) the amounts expected under the baseline (see Table 1 of the MEFP).

Table C. Ukraine: NBU Net Loans to DGF and Purchases of Government Bonds Issued for DGF Financing or Banks Recapitalization: Projections for the NDA Adjustment

(Cumulative flows from January 1, 2018, 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)
End-December 2018	-4,884	-4,500
End-March 2019	-6,484	-4,500
End-June 2019	-6,484	-4,500
End-September 2019	-6,484	-4,500
End-December 2019	-6,484	-4,500

C. Monetary Policy Consultation Clause (MPCC)

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 inflation mid-point targets and consultation bands are specified in Table 1 of the MEFP. Consultation with the IMF Executive Board will be triggered if the observed headline inflation falls outside an outer band of +4.75/-3.5 percentage points around the mid-point targets for end-March 2019 and end-September 2019. In this case, the authorities will complete a consultation with the IMF Executive Board that would focus on (i) the stance of monetary policy and whether the Fund-supported program remains on track; (ii) the reasons for program deviations, taking into account compensating factors; and (iii) proposed remedial actions, if deemed necessary. If the observed headline inflation falls outside an inner band range of +/- 2 percentage points around the mid-point targets for December 2018, March 2019, June 2019 and September 2019 and an inner band range of +/- 1 percentage point around the mid-point target for December 2019, then the authorities will complete a consultation with IMF staff on the reasons for the deviation and the proposed policy response.

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[4] (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

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

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[5] 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 (including the change in the stock of refundable participation deposits and the 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.

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

[5] 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.

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 D). 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 D).

Table D. Ukraine: External Financing of General Government Projects and Budget—Adjustment

(Cumulative flows from January 1, 2018 and January 1, 2019, in millions of hryvnia)

	External project financing (Technical assumption for the adjustor purpose)	Budget support grant (Technical assumption for the adjustor purpose)
End-December 2018	17,000	0
End-March 2019	5,000	0
End-June 2019	10,000	0
End-September 2019	15,000	0
End-December 2019	21,161	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 15 billion from January 1, 2019. The amount included in the targets is zero, and indicative cumulative amounts for bank recapitalization/DGF financing are presented in Table 1 of the MEFP.

- The ceiling on the cash deficit of the general government will be adjusted downward by the full amount of any increase in the stock of budgetary arrears on social payments accrued since the start of the fiscal (calendar) year. 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 adjusted downward by the full amount of any increase in the stock of VAT as defined in section F.

- The ceiling on the cash deficit of the general government are subject to an automatic downward adjustment corresponding to the full amount of profits transferred by the NBU in excess of the amount accounted for in the 2019 budget, as approved by the Rada on November 22, 2018.

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" and its subsidiaries (collectively, the "Naftogaz Group"). 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 D 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 Naftogaz's investment expenditure in excess of UAH 15 billion, but by no more than UAH 25 billion (corresponding to a total investment expenditure of UAH 40 billion).

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 and Pension Expenditure (Indicative Target)

19. The ceiling on the state budget current primary and pension 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 net of transfers to from the state budget to the pension fund, plus total expenditures of the pension fund, 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 and on information provided by the pension fund.

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

Definition

21. 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.

I. Ceiling on Publicly Guaranteed Debt (Performance Criterion)

Definition

22. 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.

J. Other Continuous Performance Criteria

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

II. OFFICIAL EXCHANGE RATE

A. Determination of the Official Exchange Rate

24. The NBU, on a daily basis, will set the official UAH/USD rate based on a weighted average of the exchange rates from the day's interbank market deals, excluding outliers. To calculate the official exchange rate, information on all deals concluded and provided to the NBU by trade information systems until 3:30 pm on the day will be considered regardless of the settlement date. Specifically, *tod*, *tom* and *spot* (T+2) deals will be included. Outliers are transactions for which the exchange rate deviates from the arithmetic mean for all transactions by more than 2 percent and the rate or volume deviates from the arithmetic mean for all transactions by more than 2 standard deviations. As a back-up mechanism, in case the number of transactions to be taken into account for the calculation is by noon less than or equal to 10 percent of the average daily value for the previous month, the rate will be calculated as the arithmetic mean of all quotations for purchases or sales of $1 million submitted by banks from noon to 1pm. The NBU will aim to make public its official exchange rate by no later than 4 pm of the day, preceding the one for which it is set.

III. COST RECOVERY OF GAS AND HEATING TARIFFS

25. Starting from November 1, 2018 and through December 31, 2019 (inclusive), Naftogaz shall sell/supply natural gas at the price (without VAT, natural gas transportation and distribution tariffs subject to mandatory payment in accordance with the natural gas distribution contracts) calculated in accordance with the formula:

P = (Pbase* Kd)   where:

P – (wholesale) price of selling/supplying natural gas

Pbase - average arithmetic price of selling/supplying natural gas by Naftogaz to industrial consumers under the condition of advance payment prior to the gas delivery period, effective from July 1 through September 30, 2018 according to the Price List with regard to natural gas from the resources of the NJSC "Naftogas of Ukraine" (UAH 8981 per 1000 cubic meters).

Kd - discount coefficient (ratio) equaling:

0.6943 - for calculation of natural gas prices starting from November 1, 2018;

0.8 – for calculation of natural gas prices starting from May 1, 2019.

Starting from January 1, 2020, Naftogaz shall sell/supply natural gas at the prices set between the vendor (supplier) and purchaser (consumer), but no higher than the average arithmetic gas price, at which the Company offers gas to industrial consumers under the condition of advance payment prior to the gas delivery period.

IV. REPORTING REQUIREMENTS

A. National Bank of Ukraine

26. 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 (except for SRFs for the end of the reporting year, which should be provided no later than the 41st day of the following month).

27. 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 NBU will provide data on the currency composition of reserve assets and liabilities.

28. The NBU will provide to 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.

29. 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."

30. 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.

31. 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).

32. 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.

33. 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.

34. 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 Private Capital Group.

35. 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.

36. 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.

37. 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.

38. 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 (file 3KX).

39. 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 Private Capital Group. 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.

40. 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, Private Capital Group 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 Private Capital Group 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.

41. 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.

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

43. The NBU will provide the IMF, on a monthly basis, bank-by-bank for State Participation Group, Foreign Banking Group and Private Capital Group 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).

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

45. The NBU will provide the IMF, on a monthly basis, in an agreed format, data for the entire banking sector—aggregates for Group 2 and on a bank-by-bank basis for State Participation Group, Foreign Banking Group and Private Capital Group banks the amount of loans and claims (by households in domestic and foreign currency, legal entities in domestic and foreign currency, banks in domestic and foreign currency, maturity, and by loan classification categories I, II, III, IV, and V); collateral for loans and claims (by type of collateral, legal entities in domestic and foreign currency, households in domestic and foreign currency, banks in domestic and foreign currency, and by loan classification categories I, II, III, IV, and V); provisions on loans and claims (by households in domestic and foreign currency, legal entities in domestic and foreign currency, banks in domestic and foreign currency, and by loan classification categories I, II, III, IV, and V); large exposures (loans equal to or greater than 10 percent of equity), refinanced loans, and restructured loans (by households, legal entities, and banks); the average interest rate on the outstanding stock of loans to customers (by legal entities and households; accrued interest on loans (by domestic and foreign currency); securities held for trading and available for sale, with government securities reported separately (by domestic and foreign currency); securities held to maturity and as investment, with government securities reported separately (by domestic and foreign currency).

46. The NBU will provide the IMF, on a monthly basis, in an agreed format, bank-by-bank for the State Participation Group, Foreign Banking Group and Private Capital Group banks the amount of deposits of related parties (by domestic and foreign currencies, and households and legal entities); deposits of related parties pledged as (cash cover) collateral (by domestic and foreign currencies, and households and legal entities); other liabilities to related parties (by domestic and foreign currencies); related-party loans (by households, legal entities, and banks); counterparty names and

amounts of the largest 20 loans to related parties; collateral for loans and claims on related parties (by type of collateral, legal entities, households, and banks in domestic and foreign currencies, as well as by loan classification categories I, II, III, IV, and V); provisions on loans and claims on related parties (by households, legal entities, and banks in domestic and foreign currencies, as well as by loan classification categories I, II, III, IV, and V).

47. The NBU will provide to the IMF, on a monthly basis, 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).

48. 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 Private Capital Group banks on cumulative income statements, including total revenues; interest revenues (from loans to households, loans to legal entities, interbank loans, placements with the NBU, securities); revenues from fees and commissions; total expenses; interest expenses (on deposits to legal entities, deposits to households, interbank borrowing, borrowing from NBU, securities issued); fees and commissions paid; salaries and other staff compensation; other operational expenses; net earnings before loan loss provisions; loan loss provisions; net earnings after loan loss provisions; taxes paid; net earnings.

49. 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 Private Group banks.

50. 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 Private Capital Group banks' regulatory capital has been increased. The report will disclose the instrument or transactions by which the regulatory capital has been increased (e.g., capital injection, conversion of subordinated debt to equity, etc.)

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

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

53. 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.

54. 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.

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

56. 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.

57. 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.

58. 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.

59. The NBU will provide the Fund with data relative to the interest income and principal received from January 1, 2017 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

60. 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.

61. 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.

62. 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.

63. 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.

64. 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.

65. 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

66. 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.

67. 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.

68. 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.

69. 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.

70. 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.

71. 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.

72. 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.

73. 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.

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

75. 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.

76. 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.

77. 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.

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

79. 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										

80. 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.

81. 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.

82. 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.

83. 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

84. 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.

85. 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.

86. 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 Naftogaz Group and separately for each of the entities, as defined above. This report will provide information on volumes and prices of gas purchases and sales (purchase of domestic and imported gas, sales to households, heating utilities, budget institutions, and industries), and the main revenue, expenditure and financing items. 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. 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.

87. 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.

88. 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).

89. 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.

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

91. 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

92. 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

93. 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) total value of outstanding HUS debt (f) number of refusals extended to such applications; (g) income per capita of participants, both for HUS and privileges; (h) number of household members; and (i) main reason for refusal for HUS applications (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

94. 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

95. 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

96. 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

January 4, 2019

REQUEST FOR STAND-BY ARRANGEMENT AND CANCELLATION OF ARRANGEMENT UNDER THE EXTENDED FUND FACILITY—SUPPLEMENTARY INFORMATION

Approved By
Philip Gerson (EUR) and Mark Flanagan (SPR)

Prepared By
European Department

1. **This supplement provides an update on economic and policy developments since the issuance of the staff report on December 7, 2018.**

2. **Following the issuance of the staff report for the Ukrainian authorities' request for a Stand-By Arrangement, the National Energy and Utilities Regulatory Commission (NEURC) on December 11, 2018 gave final approval to—and published in the official gazette on December 12, 2018—increases in the heating tariffs, effective January 1, 2019, to fully reflect the increase in the wholesale gas price, of all the heating companies licensed by the NEURC.** With this action, all components of the prior action regarding household gas and heating tariffs were met prior to the December 18, 2018 Board meeting, and the IMF Executive Board was informed of this during the Board consideration of the request.

Table 2. Ukraine: Prior Actions and Structural Benchmarks		
Prior actions	**Status**	**Completion date**
1. Parliamentary approval and enactment of the 2019 budget and supporting tax legislation consistent with the program target of 2.3 percent of GDP (as specified in ¶5b).	Met	
2. (i) Raising the wholesale price for gas supplied to households and district heating companies to UAH 6,236 per thousand cubic meters (excluding transmission and distribution tariffs, supplier's mark-up and VAT), effective November 1, 2018; (ii) revision of the automatic gas price adjustment mechanism to ensure that the wholesale price for gas supplied to households and for heating will be adjusted automatically effective May 1, 2019 to 80 percent of the base market price as defined in CMU Resolution 867; and (iii) and approval and publication by the National Energy and Utilities Regulatory Commission (NEURC) of increases in the heating tariffs, effective January 1, 2019, to fully reflect the increase in the wholesale gas price, of all the heating companies licensed by NEURC (as specified in ¶8a).	Met	
3. Enactment of the law on State-Owned Bank Corporate Governance (law #2491).	Met	
Proposed Structural Benchmarks		
1. Raising heating tariffs, effective January 1, 2019, to reflect the higher wholesale gas price, of all remaining heating companies with an output of up to the NEURC-set threshold for volumes of annual production and supply of heating energy—thus together covering at least 95 percent of the total centralized heating supply (as specified in ¶8a).		End-December 2018
2. Adoption by the NBU of revisions to its capital regulations to subtract loan exposures to related parties above regulatory limits from regulatory capital (as specified in ¶10b).		End-December 2018
3. Parliamentary approval of the law revisiting the supervisory responsibility for a variety of financial intermediaries ("split" law; #2413a) (as specified in ¶14a).		End-March 2019
4. Publication of first report summarizing progress in asset recovery and litigation efforts related to the four state-owned banks (as specified in ¶11).		End-March 2019
5. Consolidate the current central and regional units of the State Fiscal Service (SFS) into two separate legal entities: the Tax Service and the Customs Service by end-April 2019, which will both report to the Minister of Finance (as specified in ¶7a).		End-April 2019

Table 2. Ukraine: Prior Actions and Structural Benchmarks (concluded)	
Proposed Structural Benchmarks	
6. Following nomination by the High Council of Justice, at least thirty-five anti-corruption judges with impeccable reputation and relevant professional skills will be appointed to the HACC in line with law 2018/2447, and with rules of procedures guaranteeing the objectivity and transparency of the process (as specified in ¶15a).	End-April 2019
7. The NBU to take appropriate supervisory actions against banks that fail to comply with capital requirements (as specified in ¶10a).	End-June 2019
8. Complete an external audit of the NABU, conducted by a panel of respected experts with international experience selected in accordance with the requirements set out in the NABU Law (#1698-VII) (as specified in ¶15b).	End-July 2019

Statement by Vladyslav Rashkovan, Alternate Executive Director for Ukraine

The Ukrainian authorities thank the Fund for the continuous and fruitful engagement and helpful technical assistance. Since the deep economic crisis of 2014-2015, with strong support from the international community, Ukraine has been able to restore economic and financial stability and achieve inclusive growth by addressing key macroeconomic imbalances and advancing structural reforms. These results reflect the strong commitment of the Ukrainian authorities to sound economic policies consistent with the targets under the EFF arrangement approved by the Fund on March 11, 2015.

Within the framework of the EFF arrangement, considerable progress has been made with fostering structural reforms in several key sectors. Despite these achievements, some areas of reform have experienced delays and some of the goals of the EFF arrangement were no longer attainable before its expiration in March 2019. In order to build on the achieved progress under the EFF arrangement and to maintain a valuable anchor for economic policies in 2019 (a particularly challenging year as it includes two major elections), the Ukrainian authorities request a new 14-month Stand-By Arrangement (SBA) to succeed the EFF arrangement, which will be cancelled. The authorities are in broad agreement with staff's well-balanced assessment of the economic situation and outlook and reaffirm their strong commitment to the key policies and objectives under the Fund-supported program.

In this statement, I want to focus on (1) macroeconomic developments, (2) monetary policy, (3) financial sector policies, (4) fiscal policies, (5) energy policies, and (6) structural reforms to improve the business climate, including the anticorruption progress.

Macroeconomic developments

Macroeconomic stabilization remains on track, even overperforming in many areas. The Ukrainian economy has been recovering at a solid pace, despite the headwinds posed by the ongoing military conflict. GDP growth sped up to 2.5 percent in 2017 and at an estimated 3.2 percent in the first nine months of 2018 thanks to favorable terms of trade and robust domestic demand, both in consumption and investment. Consumption growth was supported by strong growth in real wages, pension benefits and labor migrant remittances. Business expectations improved and investment increased thanks to a favorable external price environment, the alignment of the hryvnia exchange rate with economic fundamentals and abated fighting intensity in Donbas.

Merchandise exports have been growing at a solid pace amid favorable commodity prices, robust growth in Ukraine's main trading partners and good harvests. However, imports rose faster than exports, underpinned by robust domestic demand and rising energy prices. In addition, dividend repatriation increased due to strong earnings and a gradual FX liberalization delivered by the National Bank of Ukraine (NBU). At the same time, Ukraine enjoyed massive inflows of remittances. As a result, the current account deficit has been gradually widening -to an expected 3.3 percent of GDP this year- but financial inflows were adequate to cover the current account deficit and create safeguards against a worsening global and domestic environment, raising the international reserves from US$15.5 billion end-2016 to US$17.7 billion as of end-November 2018, sufficient to cover 3 months of future imports.

Hit by several shocks, consumer inflation accelerated to 13.7 percent in 2017, exceeding the NBU's target. Since then, inflation slowed down to 10 percent yoy in November 2018, thanks to a decrease in food price pressures and tight monetary policy, partially offsetting the impact of demand-pull and cost-push factors (including labor cost and higher energy prices).

Public and publicly guaranteed debt decreased from its peak of 85 percent of GDP in 2014 to 72 percent of GDP in 2017 and is expected to further decline to about 66 percent of GDP by the end of this year, as repayments exceeded the volume of new borrowings. However, the government faces significant financing needs to repay and service external debt, which will peak in 2019–2020. Lending from the IMF and other official lenders combined with continued access to the international capital markets will help Ukraine meets its obligations.

Based on the macroeconomic stabilization achieved during the EFF arrangement, Ukraine successfully returned to the capital markets in 2017, raising US$3 billion, which provided the necessary budget financing as well as resulted in a significant decrease of the repayment needs for 2019 and 2020. In September 2018, Ukraine raised US$2 billion from the market, despite the challenging conditions.

Monetary policy

The NBU has made strong progress with implementing a rules-based, transparent and accountable monetary policy. The NBU firmly implements an inflation targeting regime and adheres to a floating exchange rate. In order to bring inflation to the target and in line with its commitment to the inflation targeting framework, the NBU took decisive actions by raising the policy rate in six steps by 550 basis points to 18 percent in 2018. In accordance with the latest NBU projections, as the result of such tight monetary stance, inflation is expected to decline to 6.3 percent by the end of 2019 (still above the NBU's medium-term target range of 5 percent +/- 1 percentage point.). It will enter the target range in Q1 2020 and reach the medium-term target of 5 percent by the end of 2020.

This year, for the first time, the NBU Council approved the medium-term Monetary Policy Strategy that defines the main goals, principles, and tools of monetary policy. Approval of the Strategy is aimed at ensuring consistency of monetary policy and immutability of its goals and principles. This will contribute to enhancing predictability and consistency of monetary policy and stabilizing inflation expectations.

Notwithstanding the turbulence in several emerging market countries, the hryvnia has remained relatively stable, allowing the NBU to buy on balance nearly US$1 billion so far this year, following net purchases of US$1.2 billion in 2017, and to continue to gradually ease administrative restrictions in line with the agreed roadmap under the EFF arrangement.

The NBU has been strongly committed to continue prudent monetary and exchange rate policies, to anchor inflation expectations and build stronger reserve buffers. Monetary policy will remain sufficiently tight in order to bring inflation down to its medium-term target. The NBU will continue implementing its inflation targeting roadmap by further enhancing the decision-making process, monetary instruments, financial market developments, and communications.

The NBU's progress with implementing a credible monetary policy framework would not be feasible without the NBU having a clear policy mandate and operational independence. The Ukrainian authorities are fully committed to maintaining and protecting the independence of the NBU.

Financial sector policies

The banking sector's health has continued to improve. Reaffirming its commitment to further strengthen bank capital, the NBU assessed banks' resilience in three stages in 2018: AQR, extrapolation of AQR results, and stress testing according to two scenarios (baseline and adverse). The test showed that capital buffers have strengthened since end-2016, and in general, the capital risks are estimated as low. The capital adequacy improved due to banks' compliance with the capitalization program/restructuring plans. Banks' profits neutralized the capital decrease caused by transferring the banking sector accounts to IFRS 9 standards. Liquidity coverage ratio (LCR) tests showed a fairly high level of liquidity in the banking sector despite the forecast of moving to a structural liquidity deficit in 2019. The banking sector slowly returns to profitability.

The level of NPLs in the system remains high. This however, does not pose a risk to financial stability, since the level of provisioning in the system is 87 percent, and the banking sector has been adequately capitalized. Several initiatives are underway to facilitate NPL resolution in the following priority areas: facilitating out-of-court restructuring, removal of tax impediments to NPL resolution, launching the Credit Register in the NBU and introducing a new insolvency law approved by the Parliament. A policy framework for NPL restructuring in state-owned banks is under preparation. In addition, the NBU, with technical support from the World Bank, is working on a regulation, in line with the European Central Bank (ECB) approach, to provide guidance to banks on how to reduce their NPL portfolios.

After the nationalization of Privatbank, the share of state-owned banks in the banking system remains high (more than 54 percent of the net assets). The government approved the Principles of State Banking Sector Strategic Reforms in February 2018 aiming to reduce its stake to 24 percent by the end of 2022. On September 1, 2018 the Ministry of Finance announced the launch of regular and detailed reporting of the key performance indicators of SOBs and the implementation of individual bank's strategies. The first publication of quarterly KPIs of SOBs has been placed on the official website of the Ministry of Finance on November 1, 2018. The authorities plan to publish every six months a separate report with the results of the SOBs' efforts to resolve NPLs.

Strengthening governance of the state banks remains a key priority for the government and the NBU in 2019: the law approved by the Parliament on November 9, 2018 envisages professionalization of the governing boards of the state banks, including the appointment of the majority of independent Supervisory Board members. In close cooperation with IFIs, the Ministry of Finance is taking measures to implement the provisions of the above-mentioned law and currently formulates the criteria for the selection process for such members.

To further develop the financial markets (improving the supervision of insurance, leasing, factoring, credit unions, pawnshops and other non-banking financial companies institutions) the government identifies as a priority the adoption of the consolidated model of financial sector supervision (“Split” law).

Fiscal policies

The authorities have achieved a drastic fiscal consolidation, reducing the budget deficit even below the program targets. In 2018, as well in 2017, Ukraine pursued a conservative expenditure approach, keeping general government finances under control. The general government deficit was below the IMF target in 2017 and the NBU and Ministry of Finance forecast similar developments in 2018.

The recently approved 2019 Budget is based on conservative assumptions: it is fiscally prudent and compliant with fiscal consolidation program targets, constraining non-priority spending. The budget process followed all required rules and procedures strictly and benefited from the full-fledged discussion. The Ministry of Finance ensures further development of the public internal financial control system (PIFC) and its harmonization with international standards and EU best practices.

In October 2017, the Parliament approved the long overdue pension reform, streamlining the Pension Fund expenditures and aiming at ensuring long-term sustainability and intergenerational equity. As a result of the reform, the pension expenditures are projected to stabilize at around 10 percent of GDP in the medium term. The government also continues to reform the Education and Health sector financing, in line with recommendations endorsed by the World Bank.

The authorities consider a thorough institutional reform of the State Fiscal Service (SFS) as a priority, to effectively collect and enforce taxes under the strengthened supervisory and control functions of the Ministry of Finance. In 2019, the efforts will be concentrated on the efficient split of the SFS into three separate authorities: the Tax Service, the Custom Service and the Financial Investigations Service, with consolidation of each service into a single legal entity. The Fund provided the respective technical assistance to Ministry of Finance and SFS in the course of 2017-2018.

On December 6, 2018, the Parliament approved the amendments to the Budget Code introducing a medium-term budgeting framework, clear fiscal rules and the fiscal risks monitoring and management system from 2019. Starting next year, the Medium-term Budget Declaration will set binding expenditure ceilings for all key spending units and focus on strategic goals and policies linking budget funds with clearly defined results. The government has also institutionalized spending reviews – the modern and powerful tool for expenditure planning and execution analysis. These instruments will improve the efficiency of the use of public funds and further support the fiscal consolidation efforts of the Government.

Energy policies

The authorities have raised the wholesale price for gas supplied to households from November 2018, recognizing the need to adjust household gas prices to market levels**.** This increase has now also been implemented for heating tariffs for the largest heating companies accounting for about 60 percent of total heating supply, while tariffs for other heating companies (overall covering no less than 95 percent of total heating supply) are expected to be adjusted by the end of this year. A further increase of 15 percent in wholesale gas prices for households and heating companies is scheduled for May 2019. Starting from January 2020, the household gas tariffs will be fully market-determined.

Thanks to the policies implemented under the EFF program, the deficit of Naftogaz has been entirely eliminated and the company is now a major source of revenue for the budget, accounting for 18 percent of budget revenues in January-November 2018. Budget revenues from Naftogaz are increasing (the proceeds for January-November 2018 are 12 percent higher than the entire previous year).

Throughout 2017-2018 the Government introduced a range of measures to improve the targeting and effectiveness of the Housing and Utility Subsidies (HUS) program. HUS eligibility rules have been strengthened to capture household income more accurately, and social norms for housing and utility services have been reviewed to reflect the actual spending patterns by vulnerable population groups. The plan is to implement the full monetization at end-user level by January 2020, so that private gas traders can compete with Naftogaz to supply gas to households and utilities, while simultaneously creating strong incentives for energy conservation. The authorities have been committed to increasing gas production to help ensure energy independence, to which end open permit and production sharing agreement tenders will be held on at least a quarterly basis.

Improving the business climate, including the anticorruption progress

The authorities demonstrated substantial progress with the privatization agenda. The new law on privatization of state and municipal property, approved in February 2018, entailed a substantial streamlining of privatization procedures. Large companies are to be sold only with the assistance of a competitively selected investment advisor to help with valuation, preparation and marketing. As of end of November 2018, seven advisor consortiums have been selected to lead the potential privatization of ten large state companies with the final sales and purchases agreements that can be governed under UK law at the request of the prospective investor. Small-scale privatization (the companies with assets under UAH 250 million) are to be sold through e-auctions using ProZorro.Sale platform. These sales started in August 2018 and already generated 400 transactions worth more than UAH 0.5 billion. Governance of SOEs will continue to be improved, and external audits of the largest SOEs will be conducted by reputable international companies.

The authorities also committed to build on recent gains in tackling high-level corruption and to deliver concrete results, leveraging on the increasing efficiency of the anticorruption institutions (some of them built in 2015-2018 as a part of the EFF arrangement: the National Agency on Corruption Prevention, the State Bureau of Investigations (SBI), the National Anticorruption Bureau of Ukraine (NABU), the Special Anticorruption Prosecutor’s Office (SAPO), and the High Anti-Corruption Court (HACC)). The authorities are committed to maintain the independence of these institutions and their integrity, to ensure that high-level corruption cases are effectively and credibly investigated, prosecuted, and adjudicated. The next decisive step will be the operationalization of the HACC, established by the Parliament in June 2018. Credible and independent HACC will ensure that corruption cases are adjudicated by judges with specialized skills and high integrity.

Concluding remarks

The Ukrainian economy is recovering: the large fiscal and quasi-fiscal deficits have fallen sharply, public debt is on a downward path, the exchange rate is flexible, inflation is declining, the central bank's international reserves have increased substantially, the financial system is getting more capitalized, liquid and profitable, and, importantly, growth has returned. Several key reforms were also advanced, notably strengthening the independence and governance of the central bank, cleaning up the banking system, adopting pension reforms, raising gas tariffs, and setting up new, independent institutions to tackle corruption.

The new requested program will support covering Ukraine's balance of payments needs by bolstering confidence and unlocking external financing and supporting the needed adjustment. The authorities remain strongly committed to the full and timely implementation of the policies under the Fund-supported program to achieve its long-term goals. The authorities are grateful for the cooperation and support from the Fund, as well as from other IFIs and the international community.