INTERNATIONAL MONETARY FUND

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UKRAINE

September 2016

SECOND REVIEW UNDER THE EXTENDED FUND FACILITY AND REQUESTS FOR WAIVERS OF NON-OBSERVANCE OF PERFORMANCE CRITERIA, REPHASING OF ACCESS AND FINANCING ASSURANCES REVIEW—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR UKRAINE

In the context of the Second Review Under the Extended Fund Facility and Requests for Waivers of Non-Observance of Performance Criteria, Rephasing of Access and Financing Assurances Review, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on September 14, 2016, following discussions that ended on May 18, 2016, with the officials of Ukraine on economic developments and policies underpinning the IMF arrangement under the Extended Fund Facility. Based on information available at the time of these discussions, the staff report was completed on September 2, 2016.
- A **Statement by the Executive Director** for Ukraine.

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

Letter of Intent sent to the IMF by the authorities of Ukraine*
Memorandum of Economic and Financial Policies by the authorities of Ukraine*
Technical Memorandum of Understanding*
Ex-Post Evaluation of Exceptional Access Under the 2014 Stand-By Arrangement
*Also included in Staff Report

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

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INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release 16/407
FOR IMMEDIATE RELEASE
September 14, 2016

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes the Second Review Under EFF with Ukraine, Approves US$1 Billion Disbursement, and Discusses Ex-Post Evaluation of 2014–15 SBA

The Executive Board of the International Monetary Fund (IMF) today completed the second review of Ukraine's economic program supported by an arrangement under the Extended Fund Facility (EFF). The completion of this review enables the disbursement of SDR 716.11 million (about US$ 1 billion), which would bring total disbursements under the arrangement to SDR 5,444.21 million (about US$7.62 billion). In completing the review, the Executive Board approved waivers for the nonobservance of performance criteria related to net international reserves, non-accumulation of external payments arrears and non-introduction of new exchange restrictions.

Ukraine's four-year, SDR 12.348 billion arrangement (about US$17.5 billion at the time of approval of the arrangement) was approved on March 11, 2015 (see Press Release No. 15/107) to support the government's economic program, which aims to put the economy on the path to recovery, restore external sustainability, strengthen public finances, maintain financial stability, and support economic growth by advancing structural and governance reforms, while protecting the most vulnerable.

The Executive Board also discussed the ex-post evaluation of the Stand-By Arrangement (SBA) with Ukraine that was approved in April 2014 (see Press Release No. 14/189).

Following the Executive Board's discussion, Ms. Christine Lagarde, Managing Director and Chair, said:

"Ukraine is showing welcome signs of recovery, notwithstanding a difficult external environment and a severe economic crisis. Activity is picking up, inflation has receded quickly, and confidence is improving. Gross international reserves and bank deposits have risen. While the social and economic cost of the crisis has been high, growth is expected to be higher in the period ahead. This progress owes much to the authorities' program implementation, including sound macroeconomic policies, bold steps to bring energy tariffs to cost-recovery levels, and measures to rehabilitate the banking system. Determined policy implementation, however, remains critical to achieve program objectives, given the significant challenges ahead.

"Further progress in fiscal reforms is key to ensure medium-term sustainability. The authorities need to avoid tax policy changes that lead to higher deficits. The focus should be on improving tax and customs administrations. Moreover, parametric pension reform is crucial to reduce the pension fund's large structural deficit, help reduce fiscal deficits and public debt, and create room to bring pensions to sustainable levels over time.

"Monetary policy has been skillfully managed and financial sector reforms have started to yield results. Priority should continue to be given to reducing inflation and rebuilding international reserves, also to make room for the gradual removal of remaining administrative measures. The authorities need to further strengthen the banking system through recapitalization, unwinding of related-party lending, and resolution of impaired assets.

"A sustainable recovery requires completing the structural transformation of the economy, where much remains to be done, including combating corruption and improving governance. Creating a level-playing field and ensuring equal application of the rule of law is essential to raise investment. A decisive start needs to be made with the restructuring and divestiture of state-owned enterprises, and prosecuting high-level corruption cases.

"Ukraine's international partners have contributed to efforts to strengthen the economy with considerable financial and technical support. These remain important for the success of the program. The completion of the restructuring of sovereign debt held by private bondholders was an important step to put debt back on a sustainable path. It is important that the resolution of remaining sovereign arrears proceeds promptly.

"The ex-post evaluation of exceptional access under the 2014–15 Stand-By Arrangement notes that while the program faced substantial risks from the outset and did not achieve many of its goals, it served as an important policy anchor in an uncertain environment."

INTERNATIONAL MONETARY FUND

UKRAINE

September 2, 2016

SECOND REVIEW UNDER THE EXTENDED FUND FACILITY AND REQUESTS FOR WAIVERS OF NON-OBSERVANCE OF PERFORMANCE CRITERIA, REPHASING OF ACCESS AND FINANCING ASSURANCES REVIEW

EXECUTIVE SUMMARY

The authorities have continued to make progress in implementing the program. Notwithstanding the delay in completing this review, mainly related to a difficult approval process of the 2016 budget and political tensions culminating in a change in government in April 2016, important policy measures have been taken since the last review. This includes a sizable fiscal adjustment; a successful completion of the debt operation with private bondholders; the increase in gas and heating tariffs to full cost recovery; and decisive steps to rehabilitate the banking system. However, progress in tackling corruption, privatizing state-owned enterprises (SOEs), and advancing pension reform has been slower than envisaged against significant political resistance.

The economy has stabilized and is showing signs of a gradual recovery. Following a severe economic crisis, activity is picking up, inflation has receded quickly, and confidence is improving. International reserves have doubled to over US$14 billion.

Continued determined policy implementation is needed to achieve program objectives, given the still significant challenges lying ahead. The new government has affirmed its commitment to the program's reform agenda. Policies in the period ahead aim to: (i) further strengthen public finances via expenditure consolidation—including pension reform—and improvements in tax administration; (ii) continue to improve banks' financial health; (iii) maintain prudent monetary policy and exchange rate flexibility; and (iv) speed up structural reforms to overhaul the SOE sector, improve the business climate, and, importantly, tackle corruption, without which the program cannot be successful. The policy agenda is ambitious, and its timely implementation remains critical.

Staff supports the completion of the second review, and the authorities' requests for waivers of the missed performance criteria, rephasing of access, and financing assurances review. All prior actions have been met, demonstrating the authorities' commitment to the program and offering assurances of their ability to achieve program objectives. The purchase available upon completion of this review would be equivalent to SDR 716.110 million, bringing total purchases under the EFF to SDR 5,444.21 million.

Approved By	
Thanos Arvanitis and Mark Flanagan	Discussions were held in Kyiv during September 22–October 2, 2015, November 12–20, 2015, and May 10–18, 2016. The IMF team comprised Nikolay Gueorguiev (outgoing mission chief, September), Ron van Rooden (new mission chief, November and May), Stephanie Eble, Etienne Yehoue, Pamela Madrid, Ricardo Llaudes, Brett Rayner, (EUR); Olga Stankova (COM); David Amaglobeli (FAD); Chanda DeLong, Ceda Ogada, Emmanuel Mathias, Sebastiaan Pompe (LEG); Luis Cortavarría-Checkley, Annamaria Kokenyne Ivanics, Ivan de Oliveira Lima, Jean Portier (MCM); Cesar Serra, Jeta Menkulasi (SPR); Jerome Vacher, Wim Fonteyne, Maksym Markevych, Ihor Shpak, Maria Sydorovych (Resident Representative office). Poul Thomsen (Director, EUR), Thanos Arvanitis (Deputy Director, EUR), Ceda Ogada (Deputy General Counsel, LEG) and Oleksandr Petryk (Alternate ED) participated in some of the discussions. Alaina Rhee and Christine Rubio (both EUR) provided support from headquarters.

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INTRODUCTION

1. **Following a deep recession, macroeconomic stabilization is taking hold**. While the crisis inflicted a significant cost on Ukraine—compressing incomes, straining the financial system, and setting public debt on an unsustainable path—the worst of the economic storm seems to be over. High frequency indicators point to a broadening revival of economic activity and inflation is receding. Gross reserves have doubled to over US$14 billion and bank deposits in domestic currency are on the rise. Growth is expected to reach 1.5 percent in 2016, supported by recovering consumer and investor confidence and a gradual easing of credit conditions. This economic turnaround is a major achievement for Ukraine—and one that was not fully assured at the outset of the program given the size of the shocks that had hit the economy.

2. **Much of this progress reflects the authorities' efforts under the Fund-supported program and the strong support of the international community**. Amid a very challenging environment—both domestically and externally—progress has been made in correcting imbalances that were exacerbated by the crisis. The budget deficit has been drastically cut amid efforts to rebalance the tax burden. The banking sector is being repaired with the closure of weak banks and the recapitalization of remaining banks. Steps have been taken to advance deregulation and SOE reform and new institutions have been set up to improve governance. Much more remains to be done, however, to create an environment conducive to domestic and foreign investment, which is critical for achieving robust and sustainable growth. In particular, tackling corruption and reducing the influence of vested interests on policy making remain key challenges, despite recent renewed efforts following encouragement from the international community.

3. **Multilateral and bilateral creditors have continued to support the authorities' reform efforts with significant financing and technical assistance**. Even though delays in reform implementation deferred some financing from 2015 to 2016, disbursements since the program approval from other multilateral and official bilateral creditors reached US$3.6 billion, and a further US$1.8 billion is expected to become available soon after completion of this review. In addition, in January 2016 the Association Agreement with the EU, including its trade component (DCFTA), entered into force, opening new trade and investment opportunities for Ukraine. However, the free trade agreement with Russia was suspended and trade and transit restrictions between the two countries have increased.

4. **The completion of the debt operation with private bondholders has also been an important milestone**. The debt exchange of sovereign and sovereign-guaranteed Eurobonds, launched in September 2015, provided significant debt service relief for the next four years and was a major step toward restoring debt sustainability and securing adequate financing of the program. Russia did not participate in the debt exchange and the Russia-held Eurobond, which has been recognized as an official bilateral claim by the Fund, is now in arrears. Litigation is underway in London, while in parallel the two sides have been discussing the restructuring of this bond.

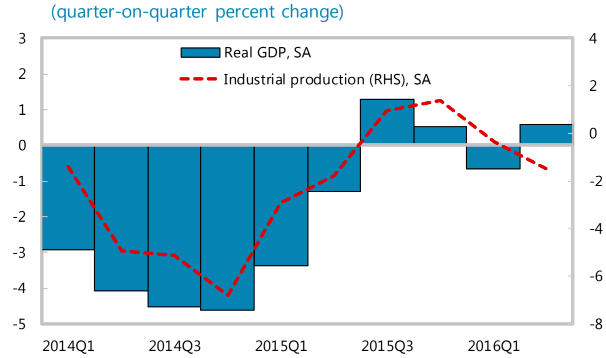
5. A new government was appointed in April 2016, following the fracture of the government coalition. Political tensions arose in late 2015 and came to a head in mid-February 2016, when the government narrowly survived a no-confidence vote, but subsequently lost its majority after two smaller parties left the coalition. A new coalition was formed in March and a new government was appointed in April. The new government stressed its commitment to accelerate the pace of economic reforms. However, the two-party coalition has a slim and fragile majority in parliament, which could challenge policy making and leaves the risk of early elections.

ECONOMIC DEVELOPMENTS AND OUTLOOK

A. Emerging from Crisis After a Sharp Adjustment of External and Internal Imbalances

6. While the 2015 recession proved more severe than initially expected, the economy has now turned the corner. Following a sharp decline in output by nearly 16 percent in the first half of2015—on top of output losses of close to 10 percent in the second half of 2014—economic activity started to recover in the second half of the year. In particular, industrial production benefitted from improving confidence and regained competitiveness, and the de-escalation of the conflict in the East, which contributed to an increase in coal and metals production. At the same time, better-than-expected output in agriculture and consumer-related sectors, such as retail trade, showed that the recovery is gradually becoming more broad-based. While these trends continued in the first half of this year, terms-of-trade shocks and the political uncertainty led to somewhat softer rebound in economic activity than initially expected (Figure 1, Table 1).

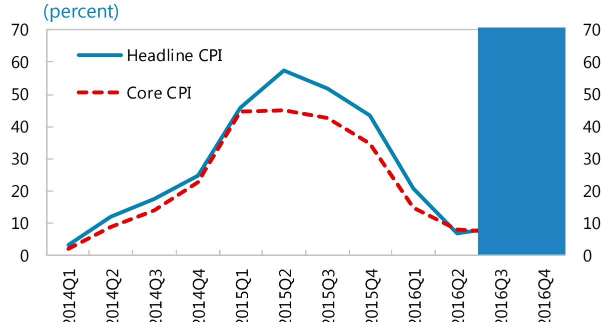
Real GDP and Industrial Production
(quarter-on-quarter percent change)



Sources: State Statistics Service of Ukraine; Haver; and IMF Staff Estimates.

7. Labor market conditions have started to improve. Unemployment is estimated to have peaked at around 9.9 percent in Q1 2016 (from 7.3 percent in 2013). Real wages declined by 18½ percent in 2015, as labor cost adjustment primarily took place through wage compression, bringing wages in dollar terms to around 30 percent of their peak in 2013. With the economic turnaround, real wages have started to recover, albeit from low levels.

Inflation and Core Inflation 1/
(percent)



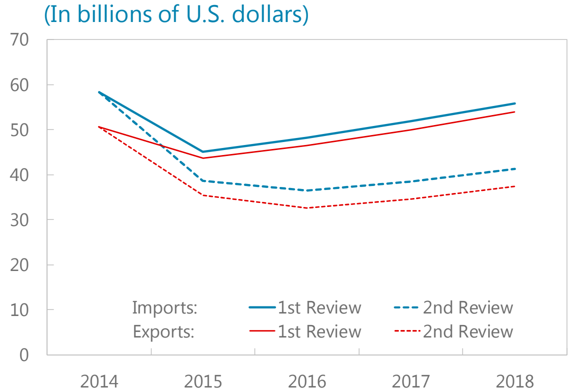
Sources: State Statistics Service of Ukraine; Haver; and IMF Staff Estimates.
1/ Staff projections from 2016Q3 onwards

8. Inflation continues to decelerate sharply as one-off effects wane. After peaking at 61 percent year-on-year in April 2015, reflecting the large exchange rate depreciation and energy tariff increases, inflation has been on a steady downward path. Weak demand, a relatively stable exchange rate, and tight monetary policy brought 12-month inflation down to 7.9 percent in July 2016 (Figure 2).

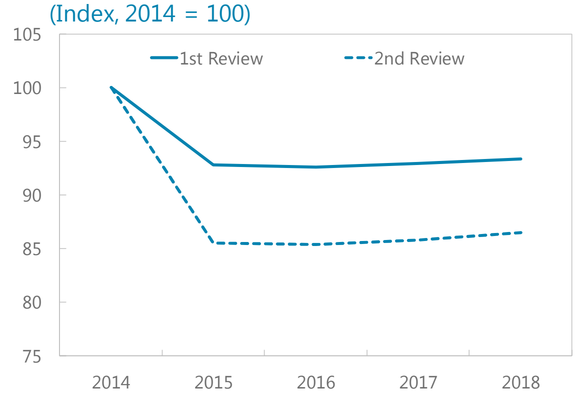
9. The NBU's firm control of monetary policy was instrumental to achieving these results. Targets for net domestic assets and base money were met comfortably, with the National Bank of Ukraine (NBU) absorbing banks' excess liquidity mainly through the issuance of certificates of deposit. With inflation and inflation expectations trending down, the NBU started easing monetary policy in April 2016, after keeping rates on hold since the summer of 2015, bringing the discount rate gradually down to 15.5 percent in July 2016. In line with program commitments, key interest rates have remained positive in real terms on a forward-looking basis (Figure 5).

10. The current account position improved significantly in 2015, but on the back of a severe trade contraction. The current account deficit narrowed to about 0.3 percent of GDP in 2015, from 4 percent in 2014. However, both exports and imports shrunk by about a third during the year. The decline in exports was due to a sharp fall in steel prices in the second half of the year and subdued demand from trading partners. Imports were compressed on the back of weak household demand, the currency depreciation, the import surcharge, as well as lower gas imports (Figure 3, Table 3). The introduction of the free trade agreement with the EU in January 2016 is expected to open new trade opportunities for Ukraine.[1] This will be somewhat mitigated, however, by the intensification of trade restrictions between Ukraine and Russia. The impact of these restrictions on Ukraine's trade balance is moderated by the continued reduction of trade between the two countries and the gradual reorientation of Ukraine's exports.

Imports and Exports of Goods
(In billions of U.S. dollars)



Terms of Trade
(Index, 2014 = 100)



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

[1] Following the introduction of the DCFTA, Russia cancelled the free trade agreement with Ukraine and imposed restrictions on several Ukrainian products as well as on transit of Ukrainian exports to third countries. Ukraine responded with import duties and restricting imports of Russian products.

11. Gross reserves reached US$13.3 billion by end-December 2015 and rose further to US$14.2 billion in August 2016. This is equivalent to about 3.5 months of imports and 55 percent of the composite metric of reserve adequacy (ARA metric), and twice the level of end-2014. Within the framework of the exchange restrictions, the NBU allowed the exchange rate to adjust to changing balance of payments conditions. The hryvnia depreciated when the terms of trade worsened in late 2015, with limited intervention by the NBU to smooth large market imbalances. Nonetheless, reflecting the lower export receipts in the second half of 2015 and delays in the disbursement in official financing, the NBU's gross and net international reserves (NIR) fell short of targets at end-December 2015 (Table 4).[2] The hryvnia recovered following the pickup in steel prices in the spring of 2016, which also allowed for an acceleration of foreign exchange purchases by the NBU, and the adjusted end-June 2016 indicative target for NIR was met. Overall, the NBU has purchased more than US$3.1 billion in the interbank market since the program's approval, while Naftogaz, in a break with past practices, has met most of its foreign currency needs from the market.

12. The fiscal stance in 2015 was much tighter than programmed and targets were met with wide margins. The combined deficit of the general government and Naftogaz was reduced sharply to 2.1 percent of GDP—compared to a target of 7.3 percent of GDP. This large fiscal adjustment was supported by higher external and one-off revenues (an exceptionally large central bank profit transfer and the temporary import duty surcharge) and a lower gas import bill (Table 2).

- ***The general government budget deficit declined to 1.2 percent of GDP***, implying a structural adjustment of around 3 percentage points. This over-performance reflects mainly higher revenues, due to higher 2015 inflation, and lower interest payments due to lower issuance of new debt and the capitalization of interest as part of the debt restructuring. The authorities used part of the room under the fiscal targets to advance the partial indexation of pensions and public sector wages to September 1, 2015 (from December 1), increase defense spending, and pay part of the January 2016 pensions already in December 2015.

Fiscal Adjustment in 2015
(percent of GDP)

	2015 outturn compared to	
	2014 (actual)	2015 (first review)
General Government plus Naftogaz	8.0	5.2
General Government	3.4	3.0
NBU profit transfer	1.7	0.0
Other revenue 1/	0.3	1.3
Non-interest expenditure	2.3	0.7
Interest	-0.9	1.1
Naftogaz	4.6	2.2
External factors	4.4	2.0
Import bill	2.8	1.5
Transit revenue	1.6	0.5
Domestic factors	0.2	0.2
Gas sales (higher tariffs)	0.8	-0.1
Domestic gas costs (UGV price)	-0.7	-0.2
Other	0.1	0.5

Sources: Naftogaz; Ministry of Finance; National Bank of Ukraine; and IMF staff estimates.
1/ Includes one-off revenue of 1.3 percent of GDP related to import duty surcharge in 2015.

- ***Naftogaz losses were reduced considerably***. Its cash deficit fell to less than 1 percent of GDP, compared to a target of 3.1 percent. This over-performance was due to much lower import volumes, as consumption declined by about 25 percent, and import prices, especially in the second half of the year, but also higher transit revenues. The gas and heating tariff increases by 285 and 67 percent, respectively, implemented in April–May 2015, helped raise domestic revenue broadly in line with expectations.

[2] To mitigate the (gross) reserves shortfall, the NBU activated its currency swaps with China and Sweden.

- ***Public and publicly guaranteed debt reached 80 percent of GDP by end-2015*** (compared to 94 percent projected at the time of the first review), due to delays in official financial assistance but also the strong fiscal performance and the observance of the bank recapitalization targets without the need for large injection of public resources to date (Figure 4).

13. Confidence in banks has started to recover, amidst continuing efforts to clean up the banking system. The NBU has suspended the licenses of almost 80 banks since 2014, accounting for 25 percent of banking system assets. Following a new round of diagnostics to reflect developments in the first half of 2015, 14 out of the 20 largest banks needing additional capital (accounting for 78 percent of the system assets) agreed with the NBU three-year plans to address further capital needs and unwind related-party exposures, and two were resolved (the remaining four banks did not need a capital increase). All of these 14 banks have now brought their capital to at least zero on the basis of the June 2016 regulatory framework.[3] With the start of balance sheet repair by banks and confidence and deposits starting to recover, credit to the economy expanded for the first time in the last quarter of 2015—mostly to enterprises—albeit still at a very slow pace. Liquidity conditions in the banking system have improved considerably (Figures 5 and 6, Table 6).

B. Outlook and Risks: A Nascent Recovery, but Risks Loom Large

14. The program's macroeconomic framework has been revised in line with recent developments:

- ***Growth***. Real GDP is projected to grow by 1.5 percent in 2016 (against 2 percent expected at the time of the first review). Economic activity will be supported by a *de facto* loosening of the fiscal stance (following the unanticipated tighter stance last year), increased consumer and investor confidence, gradually rising real incomes, and a gradual easing of credit conditions, as inflation continues to fall and monetary policy can be gradually relaxed. However, external conditions are expected to remain a drag on growth, leaving the outlook depending crucially on the strength of domestic demand.

- ***Inflation***. Inflation is projected to pick up slightly to around 13 percent toward the end of 2016, owing to the increase in gas and heating tariffs, before gradually tapering off as one-off effects subside and economic stabilization takes stronger roots.

- ***Balance of payments***. The current account deficit is expected to widen to 1½ percent of GDP in 2016 (broadly in line with earlier projections). With limited private capital inflows but strong support from disbursements by official creditors, gross reserves are projected to increase to US$16¾ billion by end-2016, and to US$31 billion by end-2018. This would be somewhat lower than envisaged at the time of the program request and the first review, largely reflecting some use of reserves to buffer the adjustment to the worsened terms of trade. Medium-term reserve adequacy will remain at broadly similar levels given the downward revision in imports.

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[3] The first round of recapitalization based on a diagnostics exercise was completed in early 2015.

Importantly, it would still surpass the 100 percent threshold of the ARA metric by the end of the program.

Gross International Reserves and Reserve Adequacy

	2015	2016	2017	2018
First Review				
GIR (in billions of U.S. dollars)	18.3	22.3	28.5	35.2
Months of next year's imports	3.7	4.2	5.1	5.8
Percent of IMF composite measure	65.4	78.8	95.1	111.5
Second Review				
GIR (in billions of U.S. dollars)	13.3	16.8	23.7	31.2
Months of next year's imports	3.4	4.1	5.4	6.5
Percent of IMF composite metric	50.8	65.0	85.7	105.0

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

15. Risks to the outlook remain large. On the domestic front, the main risk emanates from political instability, including possible early elections, policy reversals and slow program implementation. Moreover, impatience with the speed at which living standards improve and corruption is addressed could cause the public to lose confidence in the authorities' reform program. In addition, a more protracted and volatile bank resolution process could weigh on financial stability. Finally, while the ceasefire in the East is broadly holding, despite occasional interruptions, a potential escalation of the conflict could destabilize expectations and the recovery. Externally, key risks include a renewed weakening of the terms of trade and a weaker global recovery, particularly a slowdown in major emerging markets that could affect Ukraine through trade and commodity price channels.

POLICY DISCUSSIONS: FROM STABILIZATION TO SUSTAINABLE GROWTH

A. Fiscal Policy

16. The 2016 budget continues the effort to strengthen public finances, targeting a general government deficit of 3¾ percent of GDP (a ***prior action*** for this review). This is in line with the adjustment path agreed under the program. However, coming on the back of the 2015 fiscal over-performance, it effectively implies an expansionary stance, which is helpful to support the nascent recovery at a time when the external environment has turned more adverse. The relaxation in terms of the structural primary balance is about 1½ percent of GDP, as the 2015 over-performance benefited from many one-off measures.

17. While the adopted budget is broadly in line with the program, the drawn-out budget approval process revealed a significant rift between the government and parliament about the scope of tax policy changes. There was strong support in parliament for large and across-the-board tax cuts, especially of the social security contribution rate, which were seen as a way to support business activity and improve tax compliance. However, as support for commensurate spending cuts was lacking, this would have led to a considerable increase in the budget deficit that the authorities would have been unable to finance and would have threatened the hard-won gains in financial stability. In the end, and after the initial budget submitted by the government was rejected by parliament, a compromise was reached involving a major rebalancing of the budget and a combination of revenue and expenditure measures equivalent to 6.7 percent of GDP.

Fiscal Measures of the 2016 General Government Budget 1/
(In percent of GDP)

1. 2016 budget balance on unchanged policies	-5.7
2. Lowering Social Security Contributions (SSC) rate to 22 percent	-4.0
3. Increased allocation for capital spending	-0.7
4. Approved budget balance	-3.7
5. Adjustment measures needed to close the gap (4-3-2-1)	6.7
a. Revenue measures	3.6
Unify personal income tax at 18 percent with lower deductions	1.1
Expand the corporate income tax base from lower SSC	0.5
Reform the simplified tax regime for small taxpayers	0.2
Bring agriculture under general VAT regime (with transitional provisions for 2016)	0.2
Increase excise taxes on alcohol, tobacco, and fuel	0.7
Increase property taxation	0.3
Increase taxation of amber mining	0.1
Switch gas transit from royalties to VAT	0.1
Additional VAT on cigarettes	0.1
Increase profit transfers from SOEs	0.3
b. Spending measures	3.1
Impact on government wage bill of lower SSC (lower gross wages)	0.7
Reduce subsidies to SOEs, public transport, and cultural programs	0.2
Rationalize health spending (reduce hospital beds and medical staff)	0.2
Improve targeting and efficiency of social assistance	1.0
Improve targeting of non-pension benefits	0.6
Reduce benefits to working pensioners	0.2
Verification of social benefits	0.2
Increase education spending efficiency and optimize the school network	0.4
Procurement and public administration reform	0.1
Advance part of January 2016 pension payment to 2015 (temporary)	0.6

Sources: Ministry of Finance; and IMF staff estimates.
1/ Corresponds to the budget adopted in December 2015. The supplemental budget, adopted in May 2016, increased allocations for household utility subsidies (0.2 percent of GDP) and wages, pensions and social assistance (in total by less than 0.1 percent of GDP), as a compensation for higher-than-expected increase in utility tariffs. The increase in expenditure was fully offset by higher revenues related to higher gas prices.

- ***The approved revenue measures aimed at shifting taxation from direct to indirect taxes and reducing the overall tax burden*** (MEFP ¶26, and Box 1). The reduction in the overall tax burden and the rebalancing towards indirect taxes will support growth, while the simplification of the tax system will ease the burden on tax administration. Furthermore, the elimination of the special VAT regime for agriculture will expand the tax base and make the system more equitable, while the increase in rates for the simplified tax regime for small enterprises reduces the gap with the general system, although further reform will be needed to limit opportunities for tax avoidance.

- ***Spending measures aimed at permanently reducing outlays***. These measures focus on gradually improving the efficiency of spending in health care, education, and social assistance by reducing waste, better targeting, and increasing incentives (MEFP ¶29). They include *inter alia*: (i) in health care: allowing for a reduction in hospital beds and staff; (ii) in education: further optimization of the school network and better targeting of public funding; (iii) in social assistance: better targeting and verification of assistance, and continuing to reduce pensions of working pensioners by 15 percent and deny pensions to working pensioners in the civil service; (iv) procurement reform, with electronic procurement becoming mandatory for most government agencies and SOEs; and (v) a reduction in subsidies to SOEs. The budget makes space for higher investment, which had been severely compressed in the last few years. Also, as a one-off measure, equivalent to 0.6 percent of GDP, a part of the January pension payments was advanced to 2015.

Box 1. The 2016 Tax Reform

The 2016 tax reform slashed labor taxes, reduced exemptions, simplified and rebalanced the tax system towards indirect taxes, while lowering the overall tax burden. In particular, the reform:

For direct taxes:

- Replaced 67 different rates of social security contributions (SSC), which had an effective rate of about 41 percent, with a single rate of 22 percent payable only by the employer.
- Replaced two rates of personal income tax of 15 and 20 percent with a single, flat rate of 18 percent, making the system less progressive.
- Raised marginal taxation under the simplified regime for small taxpayers, which covers about 40 percent of taxpayers.

For indirect taxes:

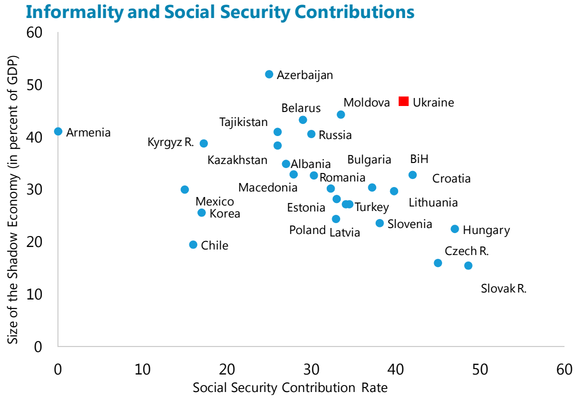
- Made the agricultural sector subject to the standard VAT rate of 20 percent from 2017 onward with a transitional arrangement in 2016, eliminating an implicit subsidy to the sector.
- Raised excise rates on tobacco, fuel, beer and spirits, reducing the still large gap compared to rates in the EU, while limiting the increase relative to other CIS neighbors (because of risks of smuggling).
- Increased property taxes on residential real estate and vehicles, particularly for wealthier individuals, which is expected to raise revenue from property taxes above some countries in the Central and Eastern Europe (CEE), but still lower than in OECD.
- Reduced royalty rates on natural gas extraction to support investments and growth in the oil and gas sector.

The reform, however, carries significant costs and risks to the 2016 budget, especially for the social security funds, given also the still weak revenue administration. The deep cut of the SSC rate implies a significant revenue loss for the social security funds (about 4 percent of GDP), which required a doubling of the state budget transfers to about 7 percent of GDP. The authorities take the view that the reduction of the SSC rates will lower the high level of informality in the labor market, create new employment and support growth. However, international experience on the link between the SSC rates and informality (Figure 1) is mixed. Also, so far social security contributions have lagged the authorities' expectations. Successfully reducing informality depends critically on strengthening revenue administration as well as addressing corruption, areas where there is still ample space for improvement. In the 2016 budget, the revenue loss is expected to be largely compensated by higher consumption taxes, which are considered to be less distortive. The reform also puts the onus on the State Fiscal Service to administer the VAT collection from the agricultural sector, which has not paid taxes in the past, and to limit the increased risk of smuggling due to higher excises.

Box 1. The 2016 Tax Reform (concluded)

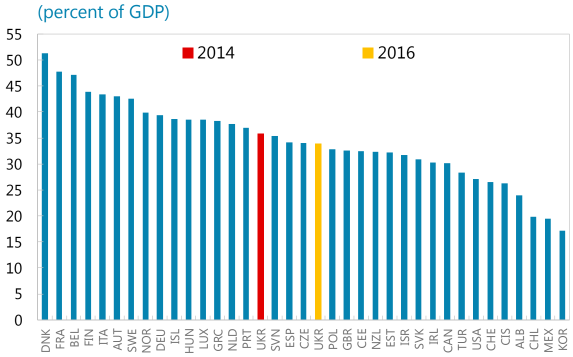
Following this reform, the overall level of taxation and tax rates in Ukraine are no longer high by international standards and the share of indirect taxes is closer to the median of CEE countries. Overall tax revenue is expected to decline to 34 percent of GDP in 2016, bringing it broadly in line with the average in the CEE. The share of indirect taxes in total tax revenue will increase to the median of the CEE countries, while the labor tax wedge, which was about 43 percent of the total labor costs and was much higher than the OECD average of 36 percent, is expected to decline by almost 9 percentage points in 2016 (Figures 3 and 4). However, the design of the simplified regime for small taxpayers remains inadequate as it still provides opportunities for arbitrage between this and the general system, and further reforms in this area could generate additional revenue (about 1 percent of GDP), while reducing distortions.

Informality and Social Security Contributions



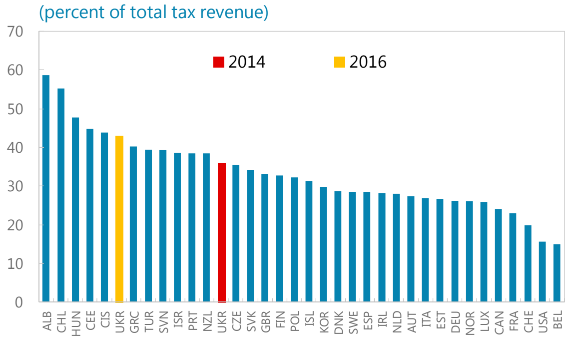
Sources: International Bureau of Fiscal Documentation; and Schneider (2010, 2015).

Tax Revenue (2014)
(percent of GDP)



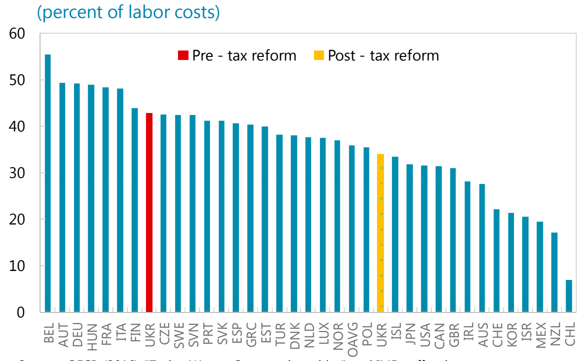
Sources: IMF World Economic Outlook; and IMF staff estimates.

Indirect Tax Revenue (2014)
(percent of total tax revenue)



Sources: IMF World Economic Outlook; and IMF staff estimates.

Labor Tax Wedge (2014) 1/
(percent of labor costs)



Sources: OECD (2016), "Taxing Wages: Comparative tables"; and IMF staff estimates.
1/ 2015 data used for Ukraine.

18. **While fiscal performance is on track, firm implementation remains critical to achieve the 2016 fiscal targets** (MEFP ¶27)**.** The authorities recognize that the extensive changes introduced with the 2016 budget will stretch tax administration and, more broadly, budget execution. In the first seven months of 2016, revenues have been performing well, including social security contributions, although not at the levels some had expected as a result of economic activities moving to the formal economy. Spending has been in line with projections, and the authorities are committed to firmly adhere to budget ceilings. Moreover, they intend to save or invest any revenue over-performance—with a new ceiling on current spending. In view of the need for further fiscal adjustment in 2017, the authorities are also committed to hold off on further major tax policy changes or other new costly policy initiatives, notwithstanding the strong support in parliament for further tax cuts.

19. The wide-ranging structural fiscal reform agenda advanced mostly in line with the program, with the exception of pension reform:

- ***Pensions*** (MEFP ¶29a). Securing the necessary support for pension reform proved more challenging than expected and the end-December 2015 structural benchmark was missed. The authorities recognize that the urgency to ensure the viability of the pension system has increased after the reduction in social security contributions, which doubled the structural deficit of the pension system to around 6½ percent of GDP (equivalent to more than half of total pension spending), requiring large budgetary transfers. Also, with the ratio of pensioners to contributors at about 1:1, a very low retirement age by international standards, adverse demographics, and low individual pensions (eroded by high inflation), broader parametric reforms will be the only way to set the pension fund on a stronger footing and to create space for gradually increasing pensions to more socially acceptable levels over time. The authorities will need to build support for these reforms and, as a first step, have reduced the number of occupations eligible for early retirement (a ***prior action*** for this review). This will be followed by broader parametric pension reforms by end-December 2016 that will improve the affordability of the system (a *new structural benchmark*) (Figure 7).

- ***Public administration and other reforms*** (MEFP ¶29). Efforts have started to reduce the size of the government. Employment in the broader budgetary sector was reduced by 3 percent and in the civil service (central and local administrations) by 16 percent in 2015. Despite declining during the last two years, the general government total wage bill in Ukraine at 9½ percent of GDP is still high by international standards, although wages in the public sector, particularly among civil servants, are on average relatively low. Further civil service reform, with the assistance of the EU, is planned to consolidate the wage bill, reduce the size of the public administration and create room for higher wage levels to attract high quality staff and reduce corruption. Other measures are also advancing, with legislation under consideration to change the basis for health care financing and to overhaul basic and professional education, as well as mandatory electronic procurement.

20. For 2016, the overhaul of the tax and customs administration is a priority (MEFP ¶27). While some progress has been made, much more remains to be done. The electronic administration of VAT was introduced on July 1, 2015 and all large taxpayers were brought under the Large Taxpayer Office (LTO) (an end-December 2015 *structural benchmark*).[4] The State Fiscal Service (SFS) now reports to the Ministry of Finance instead of to the Cabinet of Ministers, with increased operational freedom and accountability (end-December 2015 *structural benchmark*). Going forward, the authorities are committed to proceed with revamping the SFS, with a new organizational and operational structure. In this regard, the SFS has nearly completed its downsizing by 30 percent of its staff, and will consolidate tax and customs offices (a *new structural benchmark* for end-December 2016), merge audit and debt management functions, reform the dispute resolution system, strengthen taxation of high-net-worth individuals and the framework for audit and

[4] The LTO covers all large taxpayers—about 2,200, accounting for about 55 percent of government revenue.

investigation, as well as administrative enforcement of debt collection. The SFS will furthermore enhance its ability to detect and investigate offences by tax officers through its newly established investigation division, while the tax police will also be reorganized and demilitarized. As regards customs administration, reforms are also under way aiming at simplifying clearance procedures, tightening border controls, improving the valuation system and the audit function, and strengthening integrity policies.

B. Energy Sector Policies

21. Following the significant gas tariff increases, the authorities now focus on ensuring a zero deficit for Naftogaz and advancing broader gas market reforms:

- ***Gas and heating tariff increases to cost recovery*** (MEFP ¶33). Taking advantage of low international gas prices, the authorities accelerated the increase in gas and heating prices to full cost recovery one year ahead of schedule (***prior actions*** for the review; Box 2). They are committed to introducing a quarterly adjustment mechanism to ensure that prices stay at par with import prices (a *new structural benchmark* for end-October 2016) until the full liberalization of tariffs takes place, no later than April 1, 2017. In parallel, the price that Naftogaz pays for domestically produced gas was also raised to market levels, to facilitate much-needed investment in domestic gas production and to improve energy independence.
- ***Targeted social assistance*** (MEFP ¶31). By end-2015, some 5½ million households were receiving social assistance to help defray the cost of higher gas and heating tariffs. With the accelerated increase of gas tariffs, the authorities increased the envelope for energy-related benefits from around 1 percent of GDP in 2015 to 1¾ percent of GDP in 2016. The authorities have initiated reforms to improve the targeting of this support to vulnerable households and ensure that these programs remain fiscally affordable, including by: (i) streamlining the energy support programs;[5] and (ii) updating the consumption norms for the subsidy program to bring them closer to current consumption levels. The authorities will adjust the parameters of the utility-related social assistance programs, including the subsidy benefits formula, to ensure that spending remains within the allocated fiscal envelope (a *new structural benchmark* for end-September 2016).

22. Structural reforms of the sector also continue (MEFP ¶32). The new gas market law enables the unbundling of Naftogaz, including third party access to the gas transmission system. The EBRD, with inputs from other IFIs and stakeholders, has developed an action plan to establish an independent and commercially-oriented transmission system operator, which should be completed by 2017. Key initial steps in this process include government approval of the unbundling model and the transfer of state-owned assets (transmission system) to the new entity. In addition, the formula for the distribution accounts for collecting district heating bill payments has been revised to ensure that Naftogaz receives a share proportional to the cost of gas in the heating tariff and can gradually recoup heating company arrears. To foster transparency and good governance within Naftogaz, an independent audit of receivables was published in September 2015 and a comprehensive corporate governance action plan

[5] Energy privileges recipients would need to choose between the privileges and subsidy programs (but will not be entitled to both).

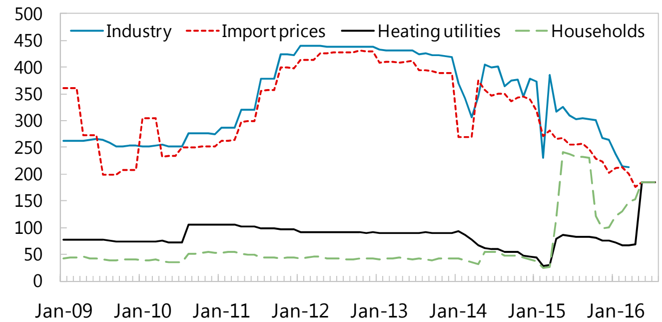
has been developed also with the assistance of the EBRD. In this context, a new supervisory board of Naftogaz with independent members was recently appointed. Finally, with support from the EBRD and the European Commission, efforts are underway to support investment in energy efficiency in the residential sector, and in particular the district heating systems.

Box 2. Gas Tariff Adjustments

Benefitting from lower international gas prices, Ukraine decided to raise gas and heating tariffs to full cost recovery levels one year ahead of schedule. The new gas tariffs became effective on May 1 and entail a 90 percent increase in the preferential (heating season) gas tariff. District heating tariffs were also increased by 110 percent, effective July 1. Including the increases in April/May 2015, gas tariffs have now increased by a total of about 425 percent and heating tariffs by about 250 percent under the program.

The tariff increases will continue to support a dramatic adjustment in the Naftogaz balance, including by reducing excessive consumption. Staff project that by the end of this year, the Naftogaz deficit will be reduced by 5.3 percent of GDP to just 0.2 percent of GDP compared to 2014. The higher tariffs have increased Naftogaz revenues and also decreased excessive energy consumption. As a result, the gas import bill is projected to fall by over 5 percent of GDP, also supported by lower international prices. Some of the overall adjustment has been offset by higher payments for domestically produced gas as these prices have also been increased to market levels to facilitate investment in domestic production and a further improvement in energy independence.

Import Prices and Gas Tariffs
(US$/tcm)



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

Naftogaz Adjustment
(In percent of GDP)

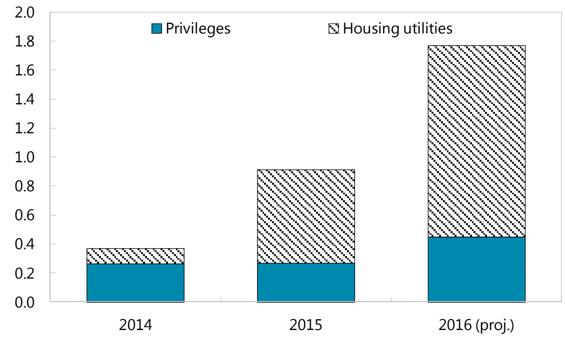
	2015 (act.)	2016 (proj.)	Total (proj.)
Reduction in NG deficit	4.6	0.7	5.3
From external factors	4.4	2.8	7.2
Import bill	2.8	2.4	5.2
Lower prices	0.7	0.2	0.9
Lower volumes	2.1	2.2	4.3
Of which: Change in storage	-1.3	0.4	-0.9
Transit revenue	1.6	0.4	2.0
From domestic factors	0.2	-2.1	-1.9
Gas sales	0.8	-0.5	0.3
Higher tariffs	1.3	1.0	2.3
Lower consumption	-0.5	-1.5	-2.0
Domestic gas costs (UGV price)	-0.7	-1.1	-1.8
Other (domestic transit)	0.1	-0.5	-0.4

Sources: Naftogaz; and IMF staff estimates and projections.

Box 2. Gas Tariff Adjustments (concluded)

Energy-related social assistance programs have been successfully expanded to support vulnerable households. For 2015, sufficient resources were allocated in the budget and delivered to about 5½ million households (about one-third of the total number of households) to help cover total utility bills. For 2016, the fiscal envelope has been increased to UAH 40.3 billion (1.8 percent of GDP), higher than the previously budgeted UAH 35 billion to help offset the advanced tariff increases.

Utility-Related Subsidies
(Percent of GDP)



Sources: Authorities and IMF staff calculations.

Further steps are needed to safeguard this progress. In particular, tariffs will be fully liberalized no later than April 1, 2017. In the meantime, the authorities will introduce a quarterly adjustment mechanism to ensure that tariffs do not deviate significantly from cost recovery should international gas prices or the exchange rate change. Continued progress on corporate governance reforms at Naftogaz, now that the supervisory board is in place, will help to further promote transparency and good governance.

C. Monetary and Exchange Rate Policy

23. **The authorities remain committed to maintaining a flexible exchange rate and further building up reserves** (MEFP ¶5). A flexible exchange rate will continue to support the required economic adjustment, while the NBU has been stepping up its efforts to purchase reserves through its foreign exchange auctions. To support the NBU in these efforts, the Ministry of Finance is expected to roll over most, if not all, of the maturing domestic foreign-currency denominated bonds. With conditions in the foreign exchange market improving, the NBU will gradually liberalize the foreign exchange market and further remove administrative restrictions, in consultation with Fund staff, to the extent that the financial stability is maintained and reserve targets are met. In this regard, in June the NBU eased restrictions on certain external trade and financial transactions, including allowing the gradual repatriation of dividends, reducing the surrender requirement, and increasing limits on deposit withdrawals and foreign-currency cash purchases by individuals.

24. **Monetary policy will continue to support disinflation and financial stability** (MEFP ¶6 and 7). With consumers' and businesses' inflation expectations still above the upper band of the NBU's inflation target for 2016, any further easing of the policy stance will be gradual, provided that disinflation and reserve accumulation are on track, inflation expectations are well-anchored, and monetary and financial stability are maintained. With inflation returning to lower levels, the NBU has stepped up its efforts to prepare for the eventual adoption of an inflation targeting framework and has published its medium-term monetary policy strategy, including inflation objectives for the coming years. The NBU also made further improvements in its operational framework that will help to improve monetary policy transmission and communications, including by narrowing the interest rate corridor and unifying the discount rate with the current key operational rate (on 14-day CDs).

25. Along with these efforts, commendable progress has been made in strengthening the NBU's institutional framework (MEFP ¶8). The NBU is moving forward with its modernization program, aiming to focus on core functions and improve its decision-making processes and internal controls. The new loan management department of the NBU is strengthening lending and risk-management processes, in line with the Fund's safeguards assessment recommendations. The NBU also adopted a new ethics code for members of its decision-making bodies and for its staff. However, some reforms, such as a new Audit Committee and adoption of an internal audit charter, had to await the appointment of a new Supervisory Council by the president and parliament. Once a new Council is appointed, a new Audit Committee with enhanced professional qualifications will be constituted.

D. Financial Sector Policy

26. The banking system is adjusting to the post-crisis environment. The number of operating banks has declined to just over 100, from 180 institutions in early 2014. Most of the nearly 80 resolved banks had significant shortcomings with regard to liquidity, solvency, and excessive exposure to related parties.

27. Remaining banks have continued to make steady progress in their recapitalization and restructuring efforts. The NBU completed the first two rounds of new bank diagnostics for the 39 largest banks (accounting for 95 percent of the system assets), focusing particularly on the sustainability of borrowers' cash flows and the quality of loan collateral. In completing this review, the NBU exercised its new legal powers that *inter alia* allow it to shift the burden of proof to a bank to demonstrate that a borrower is not a related party. Results showed material capital shortages in 28 out of the largest 39 banks. Poor quality of collateral resulted in an increase of the estimated levels of non-performing loans (NPLs) and provisioning requirements, which underscored the need for banks to enhance their credit risk management and loan underwriting practices.

- Of the initial 20 largest banks, those that needed additional capital have since brought their capital to at least zero according to the June 2016 NBU provisioning requirements, mainly by converting subordinated debt into equity, enhancing substantially loan collateral, and transferring assets to the banks' balance sheets to settle loans or have been closed. In addition, banks with related-party exposures in excess of prudential limits are now required to unwind them within the next three years.
- The diagnostics of the next 19 largest banks was completed in July 2016 and indicated that 12 of these banks needed additional capital. Shareholders' efforts to recapitalize these banks are now under way.

28. The authorities remain fully committed to continuing their efforts to rehabilitate the banking system and rebuild public trust in banks. Some of the deadlines, however, needed to be reset to better sequence their implementation (MEFP ¶11):

- ***Ensuring bank recapitalization***. Given the complexity of the process and reflecting a new regulation on credit risk that raised the capital need for some banks, the deadline for the recapitalization of the first largest 20 banks to reach a capital-adequacy ratio (CAR) of 5 percent of risk-weighted assets has been extended to end-September 2016. For the next 19 largest banks the deadline to reach the 5 percent CAR is February 2017.[6]

- ***Encouraging banks to recover loans and improve the quality of loan collateral***. Within the agreed timeframe to complete their recapitalization, banks can mitigate additional provisioning needs arising from the diagnostic exercise through effective debt collection (including by foreclosing on loan collateral) and/or the effective enhancement of problematic borrowers' creditworthiness by adding new collateral or consolidating their cash flows with those of creditworthy affiliated companies. These are subject to strict conditions regarding valuation (by independent appraisers on the basis of international best practices), sound legal documentation, and contribution to bank viability.

- ***Advancing plans to unwind related-party exposures along with recapitalization plans***. Related-party exposures that exceed limits are being addressed by banks in line with clearly-defined quarterly targets. Plans to unwind these exposures may be factored in the recapitalization plans if credible binding commitments are provided by the bank's shareholders (e.g., by pledging related deposits that could immediately be used to repay related loans if these are not repaid on time).

- ***Preventing new concentration risks***. To prevent the recurrence of banks' over-exposure to related parties, the Related Parties Monitoring Office in the NBU is reporting monthly on new potential related-party exposures, especially for banks already subjected to unwinding plans. The NBU will also set up a credit registry in line with international best practices.

- ***Ensuring non-core assets are timely disposed***. Banks will be required to dispose through end-2018 non-core assets that may have been incorporated in their balance sheets (at fair market value) as part of their recapitalization plans.

29. In parallel, to address the high stock of NPLs, the authorities are working on three main fronts (MEFP ¶19–21):

- ***Strengthening the legal framework for private debt restructuring***. New legislation will be adopted by end-September 2016 to improve the corporate insolvency regime (a *modified structural benchmark*), and by end-December 2016 to improve the credit enforcement and tax regimes.

[6] The program includes a provision for the fiscal cost of bank restructuring—including recapitalization of the Deposit Guarantee Fund (DGF)—of around 10½ percent of GDP, out of which 9 percent of GDP remains available in case of future bank needs.

- ***Adopting an out-of-court restructuring arrangement for corporate debt*** in line with international practice.

- ***Sponsoring a voluntary approach for the restructuring of foreign-currency denominated mortgage loans***, with adequate safeguards for distressed borrowers as well as banks. Simultaneously, the moratorium on collateral foreclosure will be lifted.

30. The NBU is also taking steps to enhance banking supervision and corporate governance in banks, to ensure that weaknesses identified in the bank diagnostics are addressed (MEFP ¶15). To this end, it will start supervising banks based on their risk profile, and complete ongoing work that aims to ensure that ultimate beneficiaries of bank ownership become transparent. This work will be accompanied by an assessment of corporate practices in banks with the aim to bring them in line with international best practices.

31. As part of their crisis preparedness plans, the authorities have formulated a set of principles that would guide a possible resolution of systemic banks (MEFP ¶13). A decision for state participation in the recapitalization of a problem systemic bank will be made on the basis of a technical report prepared by the NBU that assesses inter alia the bank's capital needs and viability and with the aim to avoid losses to the State. Public funds will be injected only after shareholders have been completely diluted and non-deposit unsecured creditors and related deposits are bailed in. In case a bank is nationalized, the Ministry of Finance will hire a well-known international firm to run the bank with a commercial business perspective. Moreover, international best practice will be followed and all legal means pursued to ensure that the State secures from former owners the recovery of all the loans related to them in a timely manner.

32. The authorities have adopted a strategy for the state-owned banks (SOBs) and are moving ahead with its implementation (MEFP ¶17). This strategy envisages the eventual privatization of these banks, while ensuring that in the meantime these banks operate at arm's length of the government on sound commercial principles. The authorities will appoint new supervisory boards of these banks with the assistance of a reputable international recruitment firm.

E. Structural Reforms

33. Progress in the implementation of structural reforms to strengthen the business climate and governance has been mixed. Notably, while progress has been made in setting up new institutions to fight corruption and preparations are underway to reform the SOE sector, actual outcomes have lagged. The authorities recognize the importance of accelerating the pace of structural reforms and have committed to an ambitious agenda.

Anticorruption (MEFP ¶36)

34. Notwithstanding recent efforts, progress in preventing and sanctioning corruption has generally fallen short of expectations. Opinion polls indicate that a large share of the population does not yet see the results of the anticorruption efforts, with perceptions of corruption particularly prevalent in SOEs and the judicial system. Also, corruption remains a key factor deterring foreign investment according to business surveys (Box 3). Delays in the implementation of measures to improve governance likely contributed to this sentiment. In particular, the end-September 2015 *structural benchmark* on establishing a robust anticorruption prosecution function was missed. However, following renewed efforts to accelerate the anticorruption agenda, the head anticorruption prosecutor and his two deputies were appointed in December (a ***prior action*** for this review), enabling the National Anticorruption Bureau (NABU) to become operational (an end-January 2016 *structural benchmark*). In addition, amendments to the legislation to further strengthen the appointment process were adopted in February 2016.

35. Looking ahead, the authorities support efforts to strengthen the anticorruption bureau. They recognize that gaining trust in their anticorruption efforts requires that high-level instances of corruption are investigated, prosecuted and, if warranted, convicted promptly. To this end, the authorities plan to further enhance the investigative powers of NABU (a *new structural benchmark* for end-November 2016) and to create specialized anticorruption courts and recruit specialized anticorruption judges.

36. The authorities are also taking steps to enhance transparency. While legislation requiring high-level officials to declare their assets and incomes was initially adopted in October 2014 and revised in February 2016, the effective implementation encountered delays. The authorities have now launched the electronic filing system (September 1, 2016). High-level officials have 60 days to submit their information, which would become publicly available (a *new structural benchmark* for end-October 2016).

37. Efforts are also under way to prevent the laundering of proceeds of corruption. In addition, building upon the recently developed anti-money laundering supervisory tools, the NBU is implementing targeted inspections ensuring that banks are not misused by corrupt officials. The banks' efforts to identify possible proceeds of corruption will be assisted by the publication of comprehensive asset disclosures of high-level officials, while it should also facilitate NABU investigations of the crime of illicit enrichment and associated money laundering.

Judicial Reform (MEFP ¶37)

38. Judicial reform remains critical if significant progress is to be made in addressing corruption and improving the business environment. In a recent step forward, parliament adopted a constitutional amendment and a new law on the judiciary that will allow for the organization and management of the judiciary to be more closely aligned with the standards vested in the European Convention on Human Rights, of which Ukraine is a signatory. Nonetheless, implementation is likely to be challenging. At the same time, the processes for disciplinary action against judges are being strengthened, while the new court fee system is contributing to the court budgets and a decline in spurious litigation.

Box 3. Update on Corruption and Efforts to Tackle It

Perceptions of corruption remain strong undermining public support for reforms and the business environment. Several recent corruption indicators rank Ukraine in the lowest quartile worldwide. Addressing corruption is the most pressing issue in the country for 94 percent of respondents to a poll published by the Kiev International Institute of Sociology in January 2016. Also, corruption is reported as one of the most problematic factors for business and investment in Ukraine.

The authorities have initiated efforts to set up stronger anticorruption legal framework and institutions, and promote policies reducing the scope for corruption. Legal frameworks have been strengthened to improve the criminalization of acts of corruption, make use of anti-money laundering tools to deter the proceeds of corruption, ensure comprehensive asset disclosure by senior officials, and establish anticorruption institutions.

However, the results of these efforts have been limited. So far, no high-level official has been convicted for corruption. In 2015, the national budget only received US$4,000 of confiscated proceeds of corruption. Notwithstanding some efforts, the prosecutors' office and the judiciary remain weak, and some high-level prosecutors have noted political interference in their effort to fight corruption. Overall, and as reflected by opinion polls, limited progress seems to have been made to address elite power structures that exert undue influence on the legislative and regulatory frameworks, as well as on public institutions and SOEs.[1]

The authorities have expressed their commitment to fight corruption by advancing reforms in priority areas. To this end, they recently passed legislation to improve governance in state-owned enterprises, including the appointment of independent supervisory boards and mandatory audits, transfer assets to the privatization fund and facilitate their privatization. The independent National Anti-Corruption Bureau of Ukraine (NABU) started its work in late 2015. By end-July 2016, 24 cases had been sent to court, with two court decisions requiring the restitution of US$45 million of embezzled funds, and NABU had seized more than US$175 million in financial assets. End-August 2016, the NBU announced having imposed fines on six banks, primarily due to breaches of compliance with due diligence requirements on political exposed persons. After many obstacles, the authorities have also launched the asset declaration system for high-level officials on September 1, 2016. At the same time, the authorities plan to advance reforms supporting transparency, including by streamlining business licenses, improving public procurement, reducing related-party lending and improving oversight of banks, further enhancing the privatization framework, reducing the large public sector and ensuring adequate wages, and strengthening tax administration.

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[1] See a description of the phenomenon in the Government of Ukraine Report on Diagnostic Study of Governance Issues (https://www.imf.org/external/pubs/ft/scr/2014/cr14263-a.pdf).

Deregulation and Business Climate (MEFP ¶38)

39. **The launch of land reform can release significant growth potential**. While Ukraine has a vast area of arable land, use of this land is currently limited by legislation, restricting private owners' ability to sell their land to more efficient users and constraining the use of land as loan collateral. Amending the legislation to unlock land-related transactions would generate significant economic gains, including higher incomes and greater tax revenues. New legislation on agricultural land sales is expected to be submitted by end-September 2016 (a *new structural benchmark*).

40. To accelerate the process of streamlining business procedures and strengthen transparency, the authorities will:

- ***Implement the deregulation action plan***. The streamlining and clarification of business registration and operation procedures will be completed by end-September 2016.

- ***Conduct a broad-scale review of regulatory norms***. This will include a stock taking of all norms that impact businesses, with recommendations on whether the norm should be removed, revised or maintained. In this regard, the Cabinet of Ministers has adopted an updated methodology for assessing the impact of existing regulations.

- ***Simplify business registration and operations***. By end-September 2016, the Cabinet of Ministers will approve all remaining licensing conditions not yet adopted.

- ***Improve payment discipline***. A law on payments and garnishments to facilitate the enforcement of claims will be adopted by end-September 2016 (a modified *structural benchmark*).

SOE Reform (MEFP ¶39)

41. Progress to date in the actual privatization or liquidation of companies has been limited. Steps have been taken to monitor SOE financial performances and prepare selected SOEs for privatization. In particular: (i) privatization action plans for five companies have been adopted by cabinet resolution (an end-September 2015 *structural benchmark*); and (ii) a list of 10 SOEs posing the biggest fiscal risks that will be subject to restructuring has been finalized and restructuring plans for five of these companies have been adopted (an end-January 2016 *structural benchmark*); and (iii) parliament adopted legislation to cancel mandatory sale of 5–10 percent of shares on stock exchange and to improve SOE governance by introducing supervisory boards and mandatory audits.

42. Efforts to accelerate SOE reforms include:

- ***Enhanced monitoring of fiscal risks***. A new fiscal risks management unit is being established in the Ministry of Finance to put in place an SOE fiscal risks monitoring and analysis framework that will inform the budget preparation process, by assessing the expected fiscal impact on the budget. A comprehensive statement of fiscal risks emanating from SOEs will be included in the 2017 budget.

- ***Triage of SOEs***. There are over 3,000 registered SOEs in Ukraine, with output amounting to around 10 percent of GDP. However, as a result of weak governance and ownership structures, there is limited information regarding the operating and financial state of these companies. Their systematic classification into companies for sale, liquidation, or continued State ownership will provide valuable information to guide the restructuring of the sector (a *new structural benchmark* for end-October 2016).

- ***Liquidation***. It is estimated that around 45 percent of all SOEs are not operating or not viable while still being a drain on public sector resources. However, current liquidation procedures are costly and lengthy, limiting the scope for effective liquidations. New legislation governing the transfer and liquidation of non-operating SOEs under streamlined procedures will be adopted by end-October 2016.

- ***Privatization***. Privatization is a key element of the SOE reform agenda to transfer non-strategic assets into more productive use and curb corruption. Recognizing the need to attract strategic investors and to remove the influence of vested interests, the authorities have started to establish a robust and transparent privatization framework, including the engagement of external advisors, and proper auditing of financial results. These elements are already being incorporated in the preparation for the sale of the Odessa Portside Plant, expected to take place by end-October 2016. A transparent and successful privatization of this company could generate much-needed momentum to the authorities' privatization program. Thereafter, the authorities aim to launch tenders for some of the country's regional energy distributors by end-2016 and for power generator Centrenergo by end-March 2017. Also, the privatization law will be further amended to improve transparency and safeguards, including measures to prevent asset stripping, and to further streamline the process to speed up privatization (a *new structural benchmark* for end-December 2016).

- ***Corporate governance of strategic SOEs***. This includes setting up a single national holding company with a strong governance framework that is expected to manage strategic commercial SOEs.

PROGRAM FINANCING AND MODALITIES

A. Program Financing

Debt Operation

43. The authorities' debt restructuring efforts have thus far been broadly consistent with the financing and debt objectives set under the program. In particular, and as explained in more detail in the DSA (Annex I), the debt operation launched in late summer 2015 is assessed as providing the targeted external debt service relief, placing public debt clearly on a downward path, and reducing post-program gross financing needs as originally envisaged in the program:

- ***Target 1***. The debt operation is estimated to reduce Ukraine's external debt service payments by US$15.7 billion during the program period, compared to the program target of US$15 billion.

- ***Target 2***. The debt-to-GDP ratio is projected to decline to about 73 percent of GDP by 2020 from a projected 79.2 percent without the debt operation. This would somewhat exceed the 71 percent target set under the program, but this mostly reflects a more depreciated exchange rate and a slightly slower pace of the economic recovery. The debt-to-GDP ratio is now projected to fall below 70 percent in 2021.

- ***Target 3***. The gross financing needs in 2019–25 are projected to be on average below the threshold of 10 percent of GDP and to remain below the maximum threshold of 12 percent of GDP in any single year.

44. The authorities have restructured most of the external liabilities within the perimeter of the debt operation. They have pursued a multi-track approach aimed at restructuring a total of US$22.3 billion of public and SOE debt included in the debt operation.

- ***Sovereign and sovereign-guaranteed debt***. Discussions on the restructuring of Ukraine's sovereign and sovereign-guaranteed Eurobonds (amounting to US$18 billion, including the US$3 billion Eurobond held by Russia) took place through an ad-hoc creditor committee (AHC) representing four large private bondholders holding US$8.3 billion. After several months of negotiations, an agreement on the restructuring terms—implying an NPV reduction of about 20 percent—was reached with the AHC in August 2015.[7] The exchange offer was launched in September 2015 and attracted broad creditor participation. Collective action clauses led to no holdouts, with the exception of the Eurobond held by Russia. The settlement and issuance of new instruments took place in November 2015. The restructuring of an additional US$0.5 billion of sovereign-guaranteed commercial loans of SOEs was completed in April 2016 on similar terms.

- ***Local government debt***. The city of Kyiv completed the restructuring of its outstanding Eurobonds (about US$0.6 billion) in late December 2015, with a small holdout of US$101 million by private creditors (due to a failure to trigger the collective action clause).[8]

- ***SOE debt***. The restructuring of external debt of three state-owned entities (UkrEximBank, Oschadbank, and Ukrainian Railways) for a total amount of about US$3.3 billion was also completed. The agreements involved the rescheduling of debt, with higher coupons and no nominal haircut.

45. The authorities continue to pursue efforts to reach a collaborative agreement with Russia on the restructuring of the US$3 billion Eurobond. This bond was recognized as an official claim by the IMF Executive Board in December 2015. Shortly before the bond's due date, the authorities announced a moratorium on this bond, resulting in the non-observance of the

[7] The terms included: a 20 percent nominal haircut; maturities extended to 2019–27 (versus 2015–23 under existing instruments); coupons of 7.75 percent (versus a pre-exchange average of 7.2 percent); and a value recovery instrument (a GDP growth warrant), providing potential payments to participating bondholders from 2021–40 if nominal GDP is above US$125.4 billion and real GDP growth is above 3 percent (with payments capped at 1 percent of GDP only during 2021–25).

[8] The restructuring terms mirrored those of the sovereign debt offer, but with a 25 percent nominal haircut and maturities extended to 2019–20. The authorities are also in discussion with the remaining private to reach a restructuring agreement.

continuous performance criterion (PC) on the non-accumulation of external debt payment arrears. In February 2016, Russia filed a lawsuit against Ukraine in a UK court. Ukraine submitted its defense in May and Russia has applied to the court seeking summary judgment. In parallel, discussions have taken place on the restructuring of this bond, including initial meetings at a ministerial and technical level and an exchange of offers. Although current efforts have not yet resulted in a negotiated agreement, and will need to continue in the coming months, staff assesses that they are consistent with the requirements under the policy on lending into arrears to official bilateral creditors and that the conditions are met to proceed with the review (Box 4).

Box 4. Lending into Arrears to Official Bilateral Creditors

Staff assesses that the conditions are met for the Fund to provide financing to Ukraine in line with the policy on arrears to official bilateral creditors, notwithstanding its outstanding arrears to Russia. In particular:

Prompt financial support from the Fund is considered essential and the member is pursuing appropriate policies. With exceptional balance of payment pressures and a financing gap of around US$25bn for the remainder of the program period, financial support from the Fund is considered crucial notwithstanding financial support from the international community. This financing will allow Ukraine to maintain an adequate level of reserves and avoid a deeper recession, while it undertakes critical reforms to support its economy and address the balance of payments needs, including fiscal consolidation, energy sector reform, rehabilitation of the banking system, and structural transformation of the business environment.

The debtor is making *good faith* efforts to reach agreement with the creditor on a contribution consistent with the parameters of the Fund-supported program:

- In terms of *process*, the Ukrainian authorities have welcomed the offer of Germany to act as an intermediary and have shown readiness to participate in meetings to take forward bilateral negotiation, which has been reflected in several meetings between ministers and advisors of both parties. Relevant information has been shared with the creditor on a timely basis. Initial offers from both sides have been exchanged with the most recent meeting between the parties taking place on March 2016. Further meetings are planned in the coming months.
- *Terms* offered by the Ukraine authorities are in line with the financing and debt objectives of the program and would not result in financing contributions that exceed the requirements of the program. Further, the terms offered do not imply a contribution that would be disproportionate relative to other official bilateral creditors.

Financing Contributions from Official Bilateral Creditors During Program Period 1/

			Financing Contribution		Financing Burden-Sharing	
Creditor	Debt Service Due 2015–18 ($ml)	Share in Debt Service Falling Due	Debt Service Relief ($ml) 2/	New Financing During 2015–18 ($ml)	Financing Share (Percent)	Financing Share - Debt Service Share
China	638	14.4	0	0	0.0	-14.4
USA	146	3.3	0	2,000	28.0	24.7
Sweden	0	0.0	0	100	1.4	1.4
Germany	28	0.6	0	749	10.5	9.9
Japan	59	1.3	0	931	13.0	11.7
Canada	226	5.1	0	167	2.3	-2.8
Switzerland	0	0.0	0	200	2.8	2.8
Korea	171	3.9	0	0	0.0	-3.9
Turkey	0	0.0	0	50	0.7	0.7
Russia	3,150	71.3	2,940	0	41.2	-30.1
Total	4,419	100	2,940	4,197	100	0

Source: IMF staff estimates.

1/ For purposes of this calculation, financing from European institutions, including the EU, have not been included. Excludes currency SWAP arrangements.

2/ Debt relief estimates are based on Ukraine's offer to Russia in January 2016.

Box 4. Lending into Arrears to Official Bilateral Creditors (concluded)

The decision to provide financing despite the arrears is not expected to have an undue negative effect on the Fund's ability to mobilize official financing packages in future cases. Most official bilateral creditors with exposure to Ukraine have supported Ukraine through new financing. These represent the vast majority of the total financing contributions required from official bilateral creditors. Russia is the only official bilateral creditor that has not reached an agreement with Ukraine, but efforts are under way to resolve the arrears situation. Despite taking into consideration Russia's strong track record of providing contributions in the context of Fund programs (including 17 HIPC Initiative restructurings), in the staff's view, lending into arrears to Russia is not expected to have an undue negative effect on the Fund's ability to mobilize future financing packages given the exceptional nature of the current dispute and efforts to resolve this in a timely manner.

Program Financing

(In billions of U.S. dollars)

	2015	2016	2017	2018	Total
Financing Gap	15.6	9.0	10.7	4.6	39.9
Reserve accumulation	6.0	3.1	7.0	7.5	23.7
Underlying BOP gap	9.6	5.8	3.7	-2.9	16.2
Identified Financing 1/	15.6	9.0	10.7	4.6	39.9
Bilateral and multilateral	9.8	5.4	6.3	2.6	24.2
IMF	6.5	2.3	5.4	2.9	17.2
Other multilateral/bilateral	3.3	3.1	0.9	-0.3	7.0
Multilateral	1.0	0.8	0.0	-0.3	1.5
European Union	0.9	0.9	0.7	0.0	2.5
United States	1.0	1.0	0.0	0.0	2.0
Other bilateral	0.4	0.5	0.2	0.0	1.1
Debt operation	5.7	3.5	4.4	2.0	15.7
Memorandum items:					
Project loans 2/	0.7	1.0	1.7	2.1	5.7
Multilateral	0.7	1.0	1.2	1.6	4.6
WB	0.1	0.2	0.5	0.5	1.3
EBRD	0.5	0.6	0.4	0.6	2.0
EIB	0.1	0.2	0.3	0.6	1.2
Bilateral	0.0	0.1	0.5	0.5	1.0
Gross international reserves	13.3	16.8	23.7	31.2	
Percent of composite metric	50.6	65.0	85.7	105.0	

Source: IMF staff estimates.

1/ Excludes project loans and currency swaps.

2/ Project financing to the public and private sector.

Financing assurances

46. Firm financing assurances are in place for the next 12 months, with good prospects for the rest of the program. Official financial assistance—excluding project financing and swaps—disbursed since the completion of the first review by the EU, the World Bank, Germany, Norway, and Japan was equivalent to US$2.15 billion. Another US$1 billion Eurobond issuance with U.S. guarantees, €600 million in Macro Financial Assistance from the EU (second tranche), and a US$100 million loan from the Swiss National Bank to the NBU are expected in the second half of 2016. Naftogaz has received US$300 million in gas purchase support from the EBRD, while the World Bank's issuance of US$500 million in loan guarantees to facilitate gas imports is expected during 2016. Finally, while the arrears to Russia are partly financing the program, this is expected to give way to a restructuring of the Russian-held bond consistent with program parameters. Overall, the program remains fully financed over the next 12 months. Together with strong program implementation, external financing commitments remain adequate to close the financing gap through the end of the program.

B. Exceptional Access Criteria

47. The program continues to satisfy the substantive criteria for exceptional access (Box 5). While public debt is now projected at 73 percent of GDP in 2020 (slightly above the 71 percent target), it is on a firm downward path, and there is now more certainty about the economic recovery. Delays in program implementation and the recent political developments raise concerns about the authorities' ability to implement the program. Nevertheless, adherence to the fiscal goals, the large and frontloaded increase in gas tariffs, the passage of other reform laws and the implementation of the prior actions, in addition to the authorities' commitment to the program, mitigate these concerns.

Box 5. Exceptional Access Criteria

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

Criterion 1. *The member is experiencing or has the potential to experience exceptional balance of payments pressures on the current account or the capital account resulting in a need for Fund financing that cannot be met within the normal limits.* Ukraine has experienced exceptional balance of payments pressures emanating from both the current and capital accounts, requiring financing well beyond normal limits, despite expected financial support from the international community. Notwithstanding progress achieved over the past year, official reserves remain very low covering only 45 percent of short-term debt and well below the 100 percent adequate benchmark of the Fund reserve metric. A package of capital control measures is still in place to support financial stability.

Box 5. Exceptional Access Criteria (concluded)

Criterion 2. *A rigorous and systemic analysis indicates that there is a high probability that the member's public debt is sustainable in the medium term. Where the member's debt is assessed to be unsustainable ex ante, exceptional access will only be made available where the financing being provided from sources other than the Fund restores debt sustainability with a high probability. Where the member's debt is considered sustainable but not with a high probability, exceptional access would be justified if financing provided from sources other than the Fund, although it may not restore sustainability with high probability, improves debt sustainability and sufficiently enhances the safeguards of Fund resources. For purposes of this criterion, financing provided from sources other than the Fund may include, inter alia, financing obtained through any intended debt restructuring. This criterion applies only to public (domestic and external) debt. However, the analysis of such public debt sustainability will incorporate any relevant contingent liabilities, including those potentially arising from private external indebtedness.* After the successful completion of the debt operation, public debt is projected on a clearly downward path, reaching 72.8 percent of GDP by 2020. While this is slightly higher than at the time of the first review, there is also now more certainty about the recovery. At the same time, gross financing needs remain on average significantly below DSA higher risk benchmarks during and after the program period, mitigating the risks associated with the high debt level. Sensitivity tests show that debt remains on a non-explosive path after a number of reasonable macroeconomic shocks. The shift in the composition of debt towards official debt with longer maturity and lower cost also lessens the risks. Thus, staff considers the debt to be sustainable in the medium term with high probability.

Criterion 3. *The member has prospects of gaining or regaining access to private capital markets within a timeframe and on a scale that would enable the member to meet its obligations falling due to the Fund.* The policy and financing mix under the program addresses the long-standing domestic and external imbalances needed to stabilize the economy and revive growth in the medium term. These measures, together with the successful completion of the debt operation would improve confidence in the economy, helping to bring Ukraine CDS and bond spreads down and ultimately lead to regaining market access. Staff anticipates that with a successful implementation of the program, combined with continued support from the international community, Ukraine has good prospects for regaining access to private capital markets before the end of the program period.

Criterion 4. *The policy program provides a reasonably strong prospect of success, including not only the member's adjustment plans, but also its institutional and political capacity to deliver that adjustment.* Notwithstanding delays in completing this review, the EFF is broadly on track. Key prior actions and important structural reforms, including the 2016 budget, gas market law, anti-corruption institutions, and banking resolution, as well as the large and front-loaded increase in energy tariffs have been implemented, notwithstanding the very difficult economic and political environment. While the fragile parliamentary majority is a key risk, the new authorities have recently passed long-standing program legislation demonstrating their ability to secure parliamentary support for reforms. The conflict in the East remains however a major challenge. Overall, with the authorities' strong commitment to the program and with significant technical support from the Fund and other multilateral and bilateral creditors, the prospects for program success remain strong.

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

48. Under the baseline, Ukraine's capacity to repay the Fund remains adequate, albeit subject to large risks. Repayments to the Fund over the next five years would peak at a manageable 8.1 percent of reserves in 2018. As a result of the debt operation, gross financing needs are contained during the period when the first large repayments come due to the Fund in 2018, as well as during the post-program period, mitigating risks to the Fund. With the envisaged policies and reforms, the revival of growth, the external and fiscal adjustment, and the buildup of reserves, Ukraine is expected to have adequate capacity to repay the Fund. By the end of the arrangement in early 2019, outstanding credit to the Fund is projected at about 17.6 percent of GDP, or 59 percent of gross reserves. Debt service to the Fund as a ratio of exports of goods and services would peak at 5 percent in 2018 (Table 7).

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

D. Exchange System

50. While several of the previously identified exchange restrictions and multiple currency practices (MCPs) have been removed, Ukraine continues to maintain exchange restrictions and MCPs. These are subject to Fund approval, respectively, under Article VIII, Section 2(a) and 3. The exchange restrictions that remain 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; and (ii) the requirement to transfer any gains from the purchase of foreign exchange to the state budget if it us unused and resold. The previously identified exchange restriction arising from the requirement to provide a tax clearance certificate before obtaining authorization for import payments was eliminated on September 8, 2015 and the MCPs arising from: (i) a potential spread of more than 2 percent in the exchange rates at which the NBU sells foreign exchange to successful auction bidders; and (ii) the use of the official exchange rate for exchange transactions with some SOEs were eliminated effective July 1, and June 2, 2016, respectively. A September 2015 regulation banning foreign exchange purchases for certain import payments resulted in the nonobservance of the PC on the non-imposition of restrictions on the making of payments and transfers for current international transactions, but this measure has since been removed.[9]

E. Program Monitoring

51. The attached Letter of Intent (LOI) and Memorandum of Economic and Financial Policies (MEFP) describe the authorities' progress in implementing their economic program and set out their commitments. The authorities also request waivers of non-observance of the end-December 2015 PC on the NBU's net international reserves—based also on the increased foreign exchange purchases in the second quarter of this year—and the continuous PC on the non-accumulation of external debt arrears—given the ongoing efforts to reach an agreement on the restructuring of the debt consistent with program parameters, while some of the arrears arose temporarily but have been eliminated following conclusion of restructuring agreements—and on the non-imposition of restrictions on the making of payments and transfers for current international transactions—as the measure giving rise to the restriction has been removed. Modifications to the program's conditionality are also proposed, as well as PCs for end-September 2016, end-December 2016 and end-March 2017 and indicative targets for end-June 2017, new indicative targets on inflation and government spending, and new structural benchmarks (MEFP Tables 1–2).

Structural Conditionality 1/

Fiscal		
Adopt 2016 budget consistent with the program	PA	Done
Reduce options for early retirement	PA	Done
Adopt parametric pension reform	SB	End-December 2016
Merge tax and customs administrations	SB	End-December 2016
Energy		
Raise gas tariffs to cost recovery	PA	Done
Raise heating tariffs to cost recovery	PA	Done
Ensure subsidies remain within the budget ceiling	SB	End-September 2016
Introduce automatic tariff adjustement mechanism	SB	End-October 2016
Anticorruption		
Appoint anticorruption prosecutors	PA	Done
High-level officials required to complete asset declaration	SB	End-October 2016
Strengthen investigative powers NABU	SB	End-November 2016
SOE reform and business environment		
Strengthen payment discipline	SB	End-September 2016
Strengthen corporate insolvency regime	SB	End-September 2016
Submit land reform legislation	SB	End-September 2016
Complete triage of SOEs	SB	End-October 2016
Amend privatization law to streamline processes	SB	End-December 2016

Source: IMF staff.
1/ Prior actions for the second review and structural benchmarks for Sept-Dec 2016. Detailed descriptions of these measures can be found in Table 1 of the MEFP.

52. The authorities are requesting a rephasing of access under the program. In light of the delays in completing this review and in policy implementation in some areas, notably pension reform, the authorities are requesting a reduction in the number of reviews to 11 and a rephasing of remaining access to align purchases with reform progress and balance of payments needs (MEFP Table 3).

[9] NBU Resolution 593, effective September 4, 2015 banned foreign exchange purchases for payment of imports where the goods had been cleared by customs before January 1, 2014 and at least one of the contracting parties changed, as these payments were considered as a channel for capital flight.

STAFF APPRAISAL

53. **More than one year after its approval, the program is on track and delivering positive results**. Following a severe economic crisis, activity is picking up, inflation is receding, and confidence in the national currency and the banking system are increasing. Gross international reserves have doubled, and the expected disbursement of official financing following the completion of this review will strengthen reserves further. This is a remarkable turnaround, and while the cost of the crisis to the society and the economy has been high, the end of the recession sets expectations for higher growth in the period ahead.

54. **The authorities deserve credit for their efforts to restore financial stability, notwithstanding some delays in reform implementation**. Under very difficult domestic and external circumstances, the authorities started to carry out important policies to correct past imbalances. The significant fiscal adjustment, the bold gas tariff increases to cost recovery ahead of schedule—eliminating Naftogaz's deficits that have plagued Ukraine's public finances for many years—the efforts to clean up the banking system, and the successful completion of the debt operation with private bondholders are important milestones. Some key steps have also been taken to reduce excessive regulations and red tape and take control over SOE finances. However, deeper reforms to transform the economy, privatize or close SOEs, and, importantly, tackle corruption have progressed only slowly.

55. **The task ahead is to accelerate reforms to turn the stabilization into sustainable growth, which has been a challenge in the past**. Notwithstanding the good results so far, the program will not succeed unless it is fully carried out. However, resistance to reforms from entrenched vested interests remains strong. The authorities should remain united in their determination to implement the program and avoid past stop-and-go efforts where reforms were abandoned once financial stability returned.

56. **The strong 2015 fiscal outturn and the 2016 budget demonstrate the authorities' determination to strengthen public finances**. The 2016 deficit target is ambitious but within reach. The major revenue rebalancing under way creates risks that needed to be monitored firmly. On the positive side, shifting the tax burden away from labor will help job creation. Also, steps to improve the targeting of government spending in the health, education, and social sectors are welcome, but they need to continue and deepen with more comprehensive reforms to improve the quality of services at lower costs.

57. **Further progress in fiscal structural reforms will be needed, however, to ensure medium-term sustainability**. While support for establishing a low-tax environment in Ukraine remains strong, the authorities need to be careful to avoid changes that will lead to a higher deficit and push the program off track. With the main tax rates not high by regional standards, it is far more effective—and pressing—to focus on improving the still weak tax and customs administration, which is essential to improve the business climate. Also, while socially unpopular, it will be crucial to address the large structural deficit of the pension system by adopting parametric pension reforms.

Without this, it will prove difficult to achieve the necessary reduction in fiscal deficits and public debt and create room to increase pensions to socially sustainable levels over time.

58. **Impressive strides have been made to reduce the fiscal burden of the energy sector by bringing prices to full cost recovery levels one year ahead of schedule**. This progress needs to continue by ensuring continuous tariff adjustment to maintain prices at market levels, which coupled with efforts to improve energy efficiency can reduce Ukraine's energy over-consumption. Efforts should also focus on establishing a transparent and open gas market and enhancing corporate governance of Naftogaz.

59. **The NBU's role has been pivotal in safeguarding financial stability**. Monetary policy has remained appropriately tight and the NBU has been successful in shoring up confidence. Further steps to lower interest rates should be conditional on continued progress with disinflation, but also on the continued strengthening of the country's external position. While lower interest rates would help support the nascent recovery and balance sheet repair, priority should continue to be given to rebuilding international reserves, which will make room to gradually remove the administrative measures that have played a critical role in guarding against balance of payments pressures, but that are ultimately distortive. With reserve targets having been adjusted to provide a buffer while Ukraine adapts to the more adverse external environment, there is now little further room to reduce reserve coverage without threatening the program's success. The NBU should continue its ambitious efforts to revamp the monetary policy framework, setting the stage for moving to inflation targeting when conditions allow.

60. **Efforts to establish a sound banking system have started to bring results, but need to continue on the current timetable**. With the first round of bank recapitalization successfully completed and with significant progress in closing insolvent or illiquid banks, the second round of bank diagnostics underscored the need for the NBU to persevere with its strategy to strengthen the banking system's health through recapitalization, unwinding of related-party lending, and resolution of impaired assets. Safeguarding financial stability will remain of vital importance to maintaining macro-economic stability.

61. **A sustainable recovery, however, will not be feasible without the structural transformation of the economy, including combating corruption**. The commitment to structural reforms needs to be matched by results. Creating a level playing field and ensuring equal application of the rule of law, including by improving governance and fighting corruption, is essential to attract domestic and foreign investment. A decisive start needs to be made with the restructuring and divestiture of state-owned companies, and prosecuting high-level corruption cases. Effective new institutions and processes are important to improve transparency and governance, but these by themselves are not sufficient. It is critical to show concrete results that signal a distinct and irreversible brake with the country's past. This will be challenging when corruption is widespread and deeply entrenched and will require deep commitment from those in power. Without this, however, it will be difficult to see how the program can succeed.

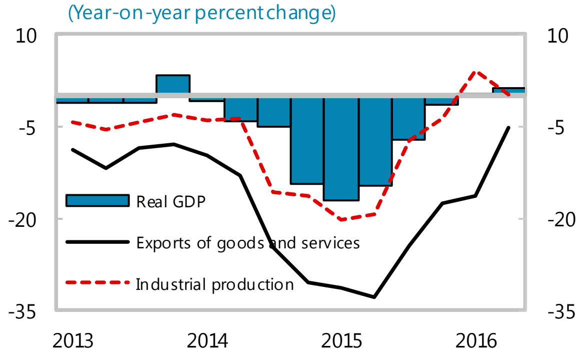
62. Continued external support remains important for the program to meet its objectives. Ukraine's international multilateral and bilateral partners are providing significant support to the authorities' efforts to strengthen the economy and restore debt sustainability. In addition, private bondholders generally supported the completion of the debt operation, which is an important step to put debt back on a sustainable path. It is now important to continue efforts to reach an agreement on the restructuring on Ukraine's debt held by Russia in line with program parameters. Firm commitments of full program financing are in place for the next twelve months and good prospects of adequate financing exist for the remaining program period, providing adequate safeguards to the Fund for the further use of the Fund's resources.

63. In view of the authorities' performance under the program, their commitments for the period ahead, and their continued efforts to restructure external debt in line with the program's objectives, staff recommends completion of the second review and the financing assurances review under the EFF. In the staff's view, the Fund may provide financing in line with the Fund's policy on lending into arrears to official bilateral creditors given that the criteria underpinning the Fund's arrears policy are satisfied. Staff also supports the authorities' request for a waiver of the end-December 2015 PC on the NBU's net international reserves based on corrective actions taken, and the waiver of the continuous PC on the non-accumulation of external debt arrears discussed in paragraph 51. Staff also supports the waiver of the PC on the non-imposition of new restrictions on the making of payments and transfers for current international transactions as the newly imposed restriction was only temporary and subsequently removed. Staff supports the authorities' request for approval of the retention of the exchange restrictions and multiple currency practices for a period of 12 months, which are inconsistent with their obligations under Article VIII Sections 2(a) and 3 as described in paragraph 50 on the grounds that they are non-discriminatory, imposed for balance of payments reasons, and temporary. Staff furthermore supports the authorities' request for the rephasing of remaining access under the program, including to better align financing with policy implementation.

Figure 1. Ukraine: Real Sector Indicators, 2013–16

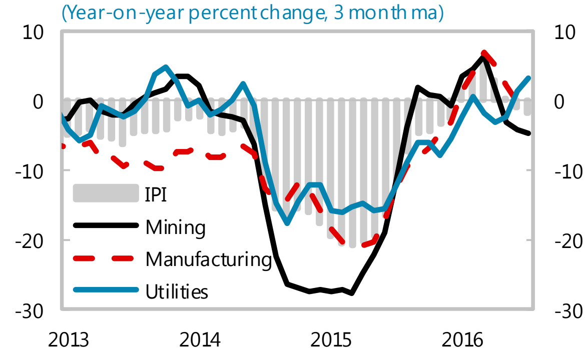
After a severe crisis, consequtive real GDP expansion in 2016H1 for the first time since 2012...

Real GDP, Exports, and Industrial Production
(Year-on-year percent change)



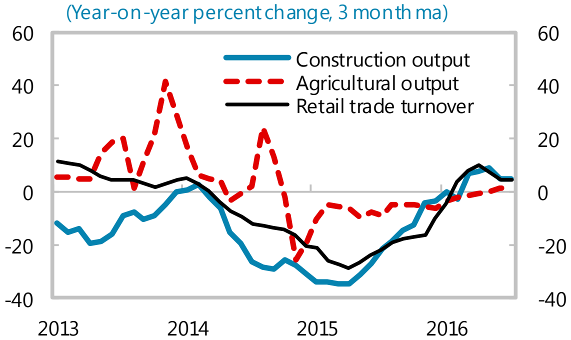
...supported by a turn-around in industrial production.

IPI Main Components
(Year-on-year percent change, 3 month ma)



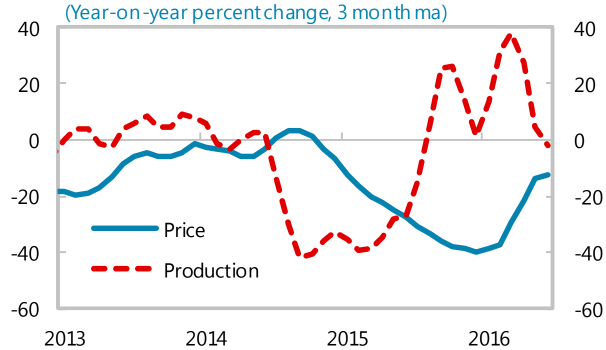
Recovery is becoming broad-based as other sectors have also turned the corner...

Agriculture, Construction, and Retail Trade
(Year-on-year percent change, 3 month ma)



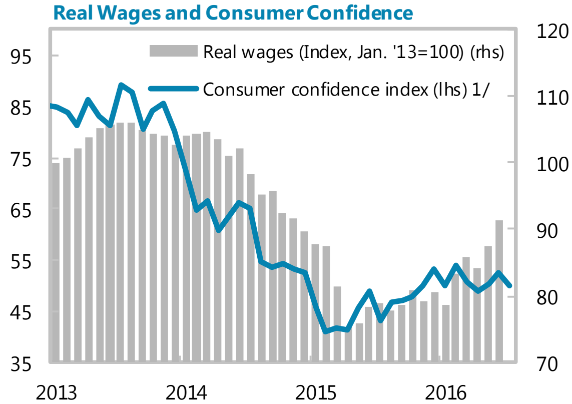
...but is however dependant on volatile steel prices and production.

Steel Production and Prices
(Year-on-year percent change, 3 month ma)



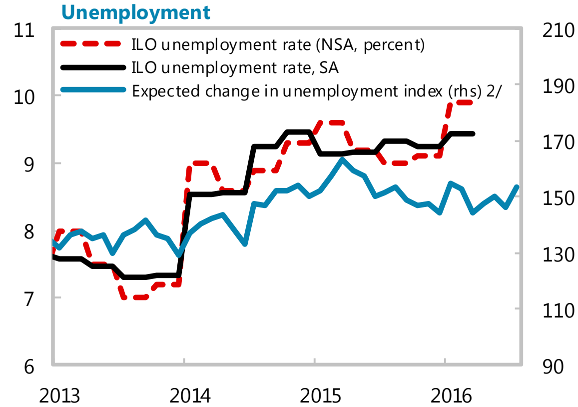
Real wage gains are supporting recovery in consumer confidence.

Real Wages and Consumer Confidence



While unemployment appears to be peaking.

Unemployment



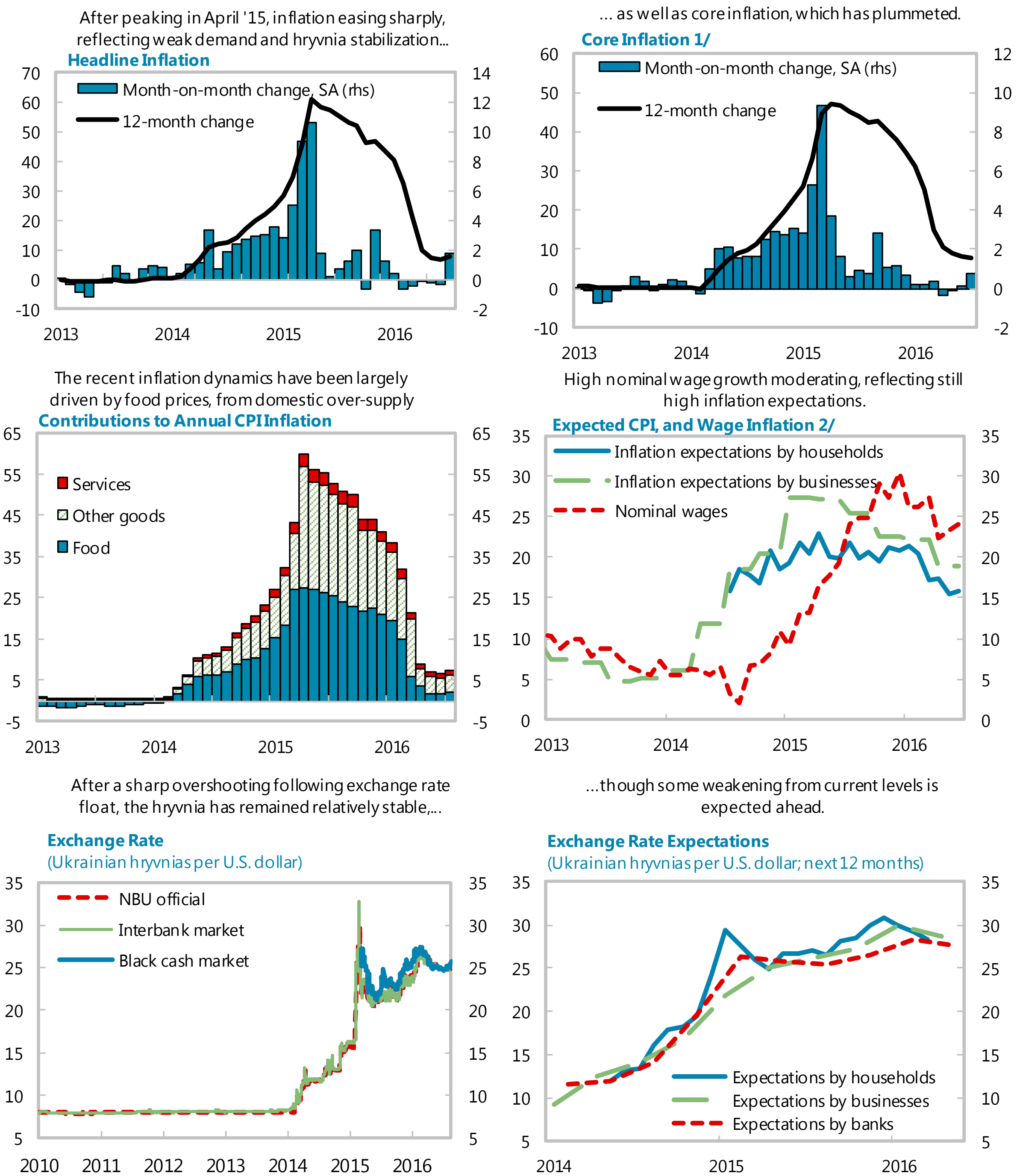
Sources: State Statistics Committee of Ukraine; Haver; Bloomberg; GFK Ukraine; International Centre for Policy Studies; and IMF staff calculations.

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

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

Figure 2. Ukraine: Inflation and Exchange Rate Developments, 2013–16

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



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

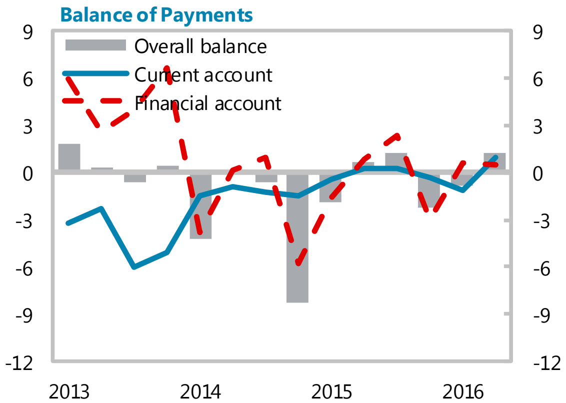
1/ Broad core excludes unprocessed food, fuel, and administrative services.

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

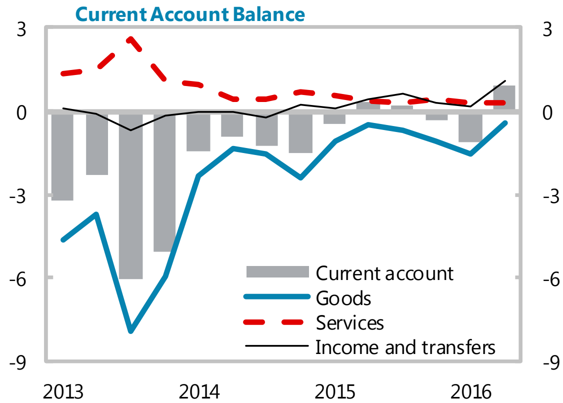
Figure 3. Ukraine: External Sector Developments, 2013–16

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

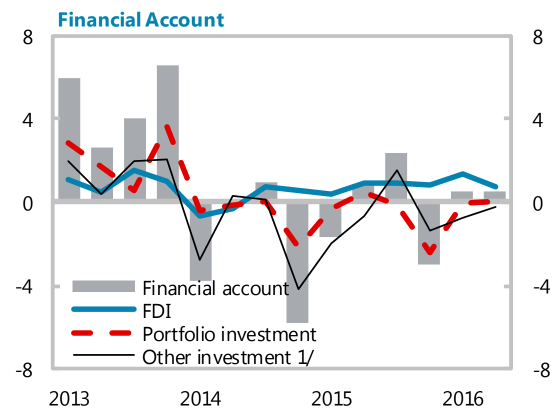
The recovery of the external position that started in 2015 has continued into 2016H1.



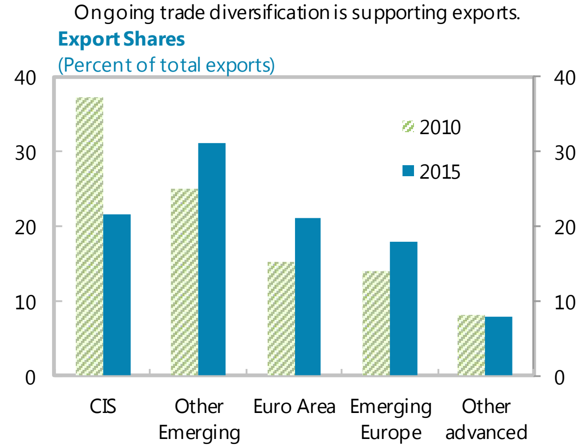
The current account has remained roughly balanced through 2016H1...



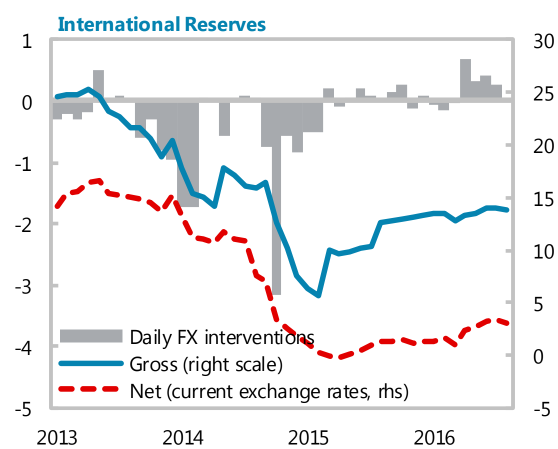
...and net capital outflows have been easing.



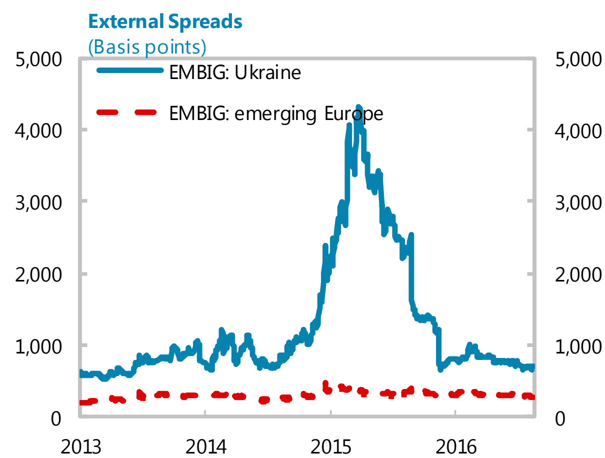
Ongoing trade diversification is supporting exports.



Reserves are recovering following increasing interventions in April-June 2016.

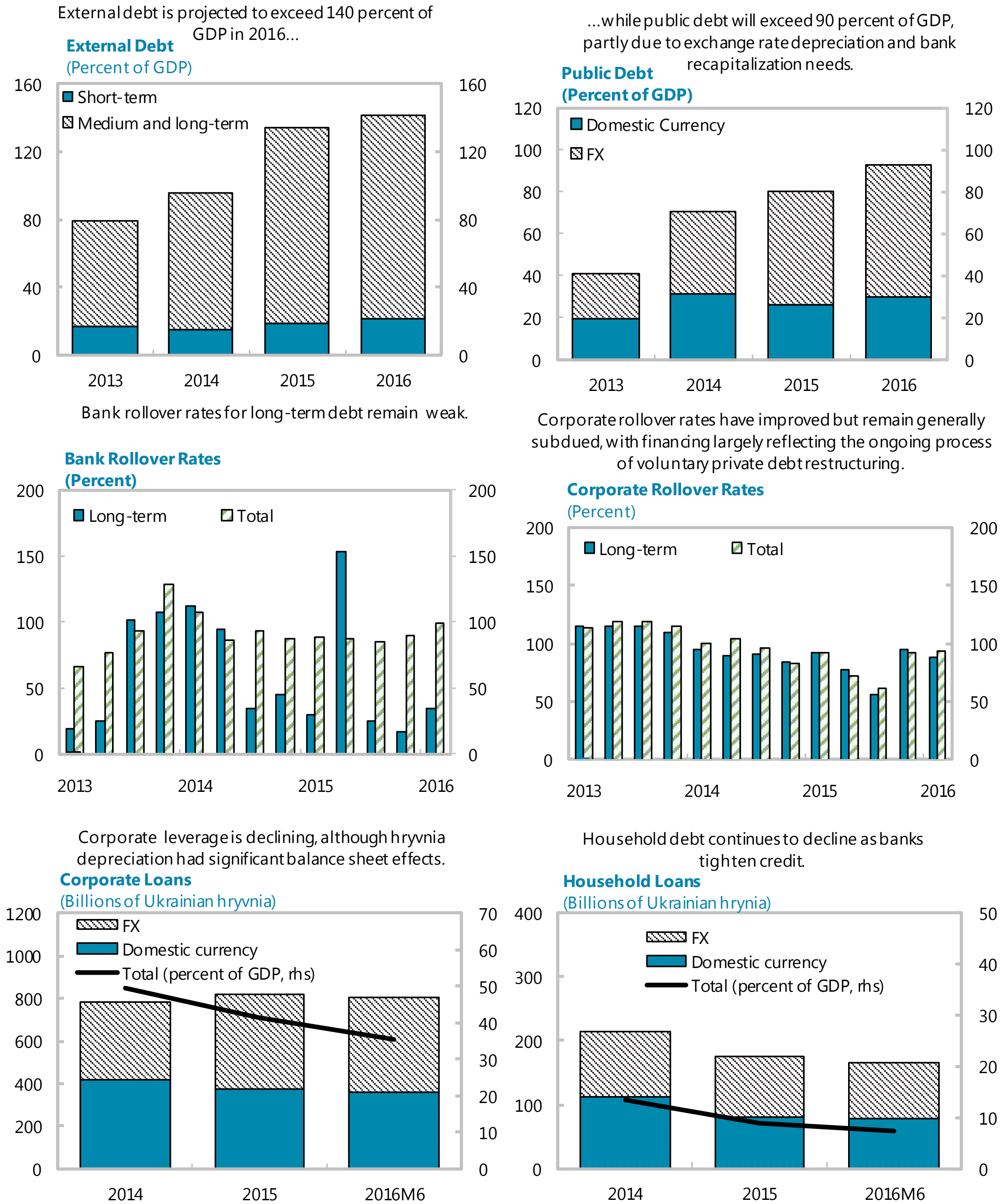


Spreads dropped significantly following the debt agreement and have remained stable in recent months.



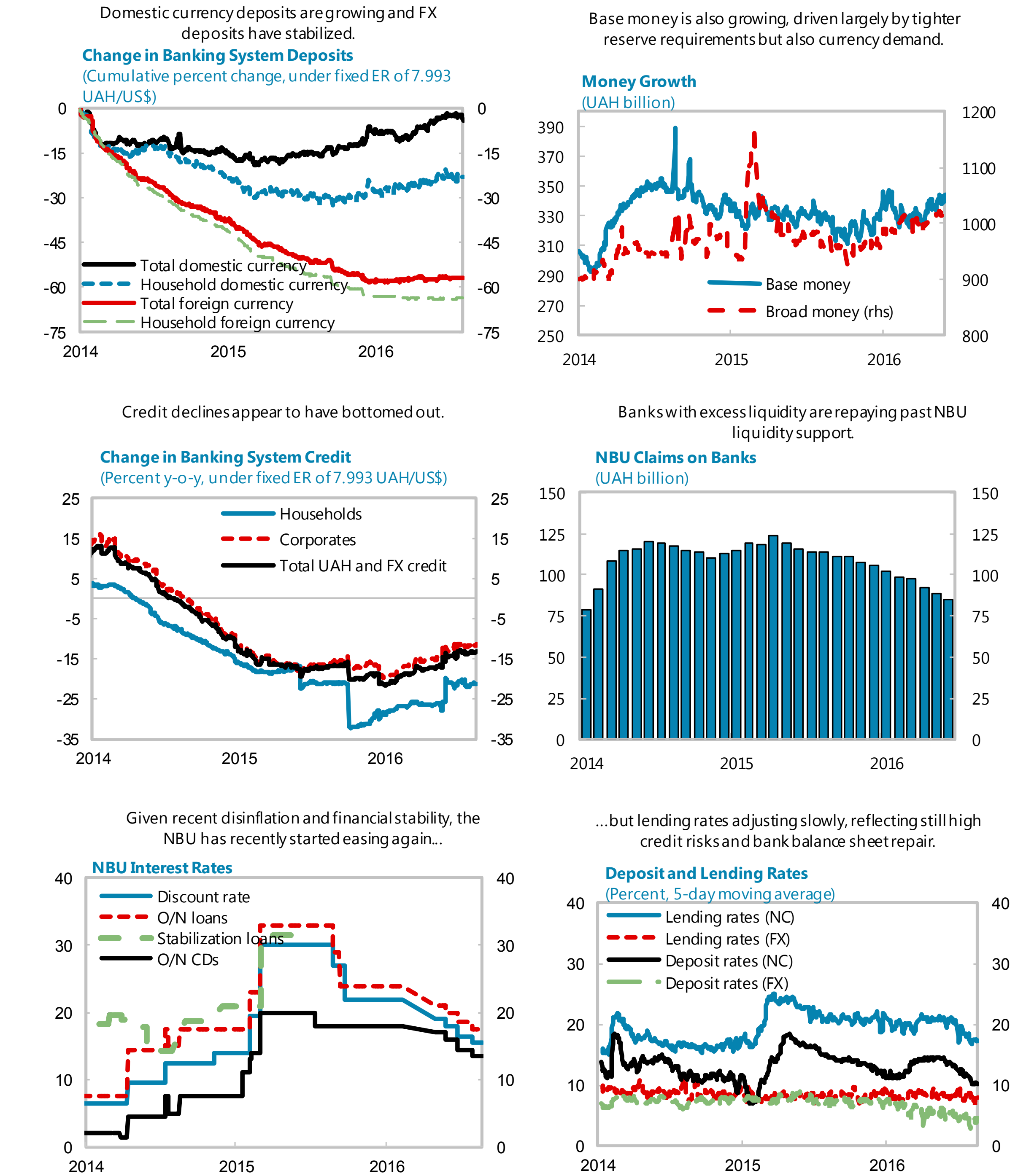
Sources: National Bank of Ukraine; State Committee of Statistics; Bloomberg; and IMF staff estimates and calculations.
1/ Includes residents' conversion of hryvnia cash to foreign currency held outside the banking system.

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



Sources: National Bank of Ukraine; Bloomberg; Ministry of Finance; and IMF staff estimates.
1/ 2016 are projections.

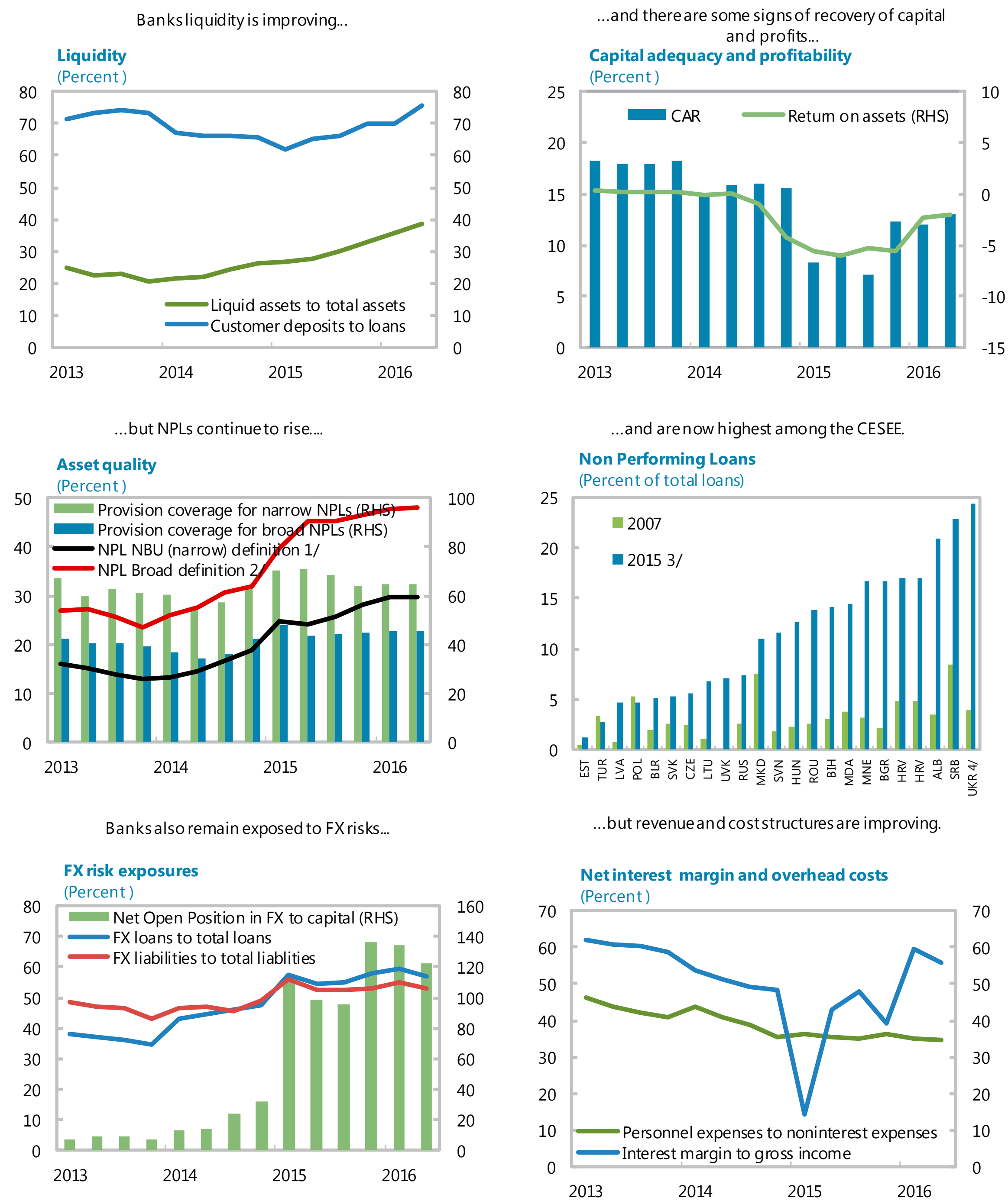
Figure 5. Ukraine: Banking Sector Deposits and Credit, 2014–16



Sources: National authorities; and IMF staff calculations.

Figure 6. Ukraine: Financial Sector Indicators, 2013–16

(Billions of Ukrainian hryvnias, unless otherwise indicated)



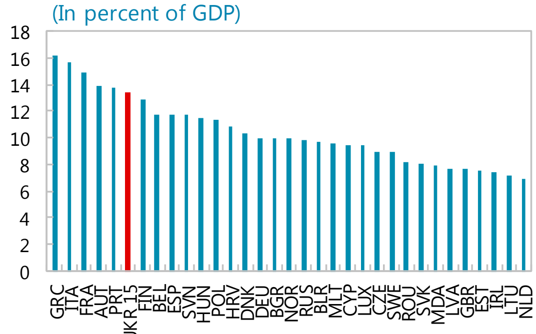
Sources: National Bank of Ukraine; World Bank WDI ; and IMF staff calculations.
1/ From December 2012, narrow NPLs are credits classified as doubtful or loss.
2/ Includes also credits in substandard category.
3/ Or latest available.
4/ For 2007, 2008 NPL value used for consistency in methodology with other countries.

Figure 7. Ukraine: Public Pension System

Public pension spending in Ukraine is one of the highest...

Public pension spending, 2013

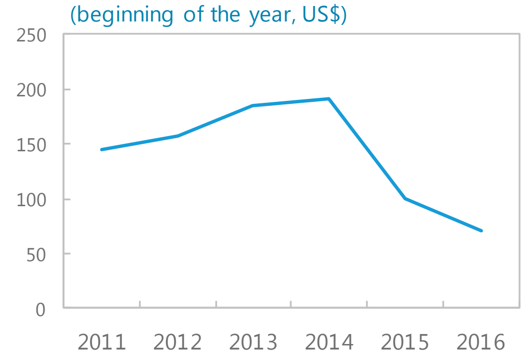
(In percent of GDP)



...despite very low pensions, which have been significantly eroded in US$ terms.

Average pension

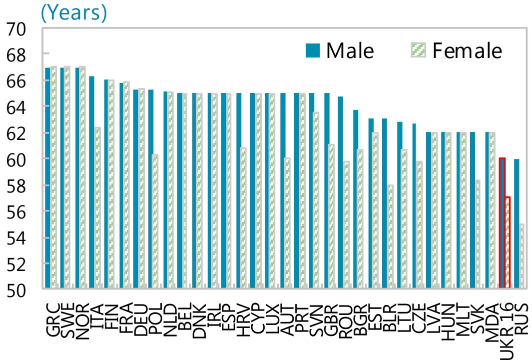
(beginning of the year, US$)



This is because of the many pensioners, given the still very low statutory retirement age...

Statutory Retirement Age, 2013

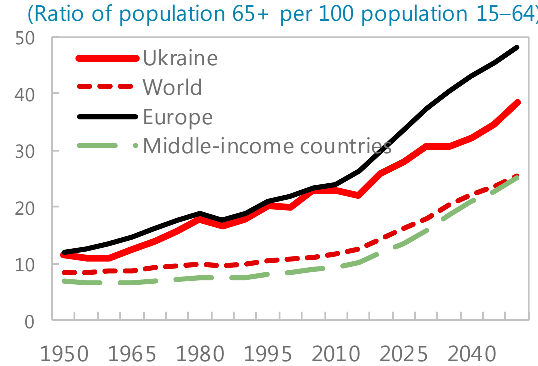
(Years)



...whose number will even further increase due to adverse demographic developments.

Old Age Dependency, 1950-2050

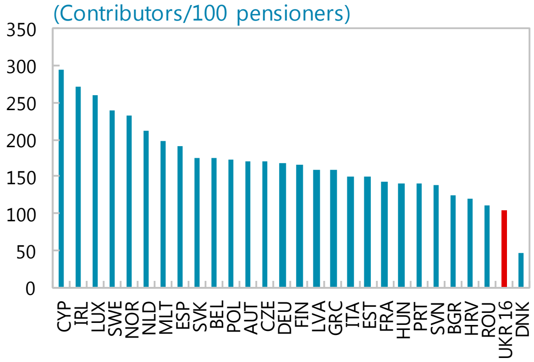
(Ratio of population 65+ per 100 population 15–64)



As a result, the contributor to pensioner ratio is one of the lowest worldwide....

Support ratio, 2013

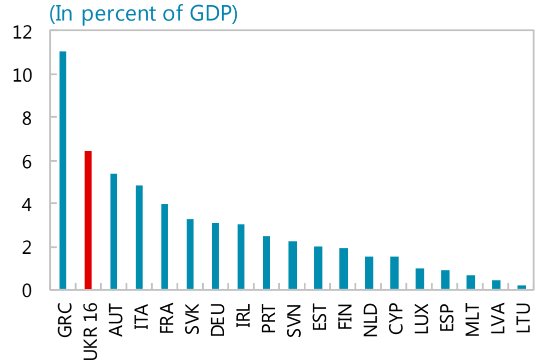
(Contributors/100 pensioners)



...contributing to the unsustainable high deficit in the pension fund.

Deficit of the pension system, 2013

(In percent of GDP)



Sources: European Commission Aging Report 2015, UN World Population Prospects 2015, Ukrainian authorities and IMF staff estimates.

Figure 8. Ukraine: Structural Reforms

Sources: World Bank, *Doing Business Indicators*; Transparency International, *Corruption Perceptions Index*; Heritage Foundation, *Index of Economic Freedom*; World Bank, *World Governance Indicators,* ; and IMF staff calculations and estimates.
Note: Baltics includes Estonia, Latvia, and Lithuania; CE-5 includes Czech Republic, Hungary, Poland, Slovak Republic, and Slovenia; SEE-EU includes Bulgaria, Croatia, and Romania; SEE-XEU includes Albania, Bosnia and Herzegovina, Kosovo, Montenegro, and Serbia. Regional groupings are calculated as the simple average of all countries in the region.
1/ Index from 1 (the worst) to 7(the best performer).
2/ The "frontier" represents the highest performance observed for each indicator across all economies in Doing Business. Scale from 0 (the lowest performance) to 100 (the frontier).
3/ CESEE includes Estonia, Czech Rep., Poland, Turkey, Lithuania, Latvia, Slovenia, Hungary, Bulgaria, Russia, Slovak Rep. Montenegro, Ukraine, Romania, Croatia, Bosnia and Herzegovina, Serbia.
4/ Score indicates the perceived level of public-sector corruption. A high score corresponds to high perception of corruption. Regional groupings are calculated as the simple average of all countries in the region.
5/ Calculated as the normalized average of six indices from the World Bank Governance Database: rule of law, political stability and absence of violence, control of corruption, government effectiveness, regulatory quality, and voice and accountability.

Table 1. Ukraine: Selected Economic and Social Indicators, 2015–21

	2015		2016		2017	2018	2019	2020	2021
	1st Review	Act.	1st Review	Prog.	Proj.	Proj.	Proj.	Proj.	Proj.
Real economy (percent change, unless otherwise indicated)									
Nominal GDP (billions of Ukrainian hryvnias) 1/	1,981	1,979	2,262	2,281	2,596	2,916	3,216	3,546	3,911
Real GDP 1/	-9.0	-9.9	2.0	1.5	2.5	3.0	3.5	4.0	4.0
Contributions:									
Domestic demand	-13.1	-14.0	2.9	2.7	3.4	3.8	4.2	4.6	4.6
Private consumption	-8.2	-16.0	2.1	2.0	2.1	2.2	2.4	2.5	2.5
Public consumption	-1.6	0.2	-0.3	-0.3	0.0	0.0	0.0	0.1	0.1
Investment	-3.3	1.8	1.1	1.1	1.2	1.5	1.8	1.9	2.0
Net exports	4.1	4.1	-0.9	-1.2	-0.9	-0.7	-0.6	-0.6	-0.6
GDP deflator	39.0	38.4	12.0	13.5	11.0	9.0	6.5	6.0	6.0
Output gap (percent of potential GDP)	-5.4	-6.8	-3.3	-3.9	-2.1	-1.2	-0.6	-0.1	0.0
Unemployment rate (ILO definition; percent)	11.5	9.1	11.0	9.0	8.7	8.4	8.3	8.1	8.0
Consumer prices (period average)	50.0	48.7	14.2	15.1	11.0	8.0	6.5	5.5	5.0
Consumer prices (end of period)	45.8	43.3	12.0	13.0	8.5	6.5	6.0	5.0	5.0
Nominal monthly wages (average)	22.3	21.1	16.5	17.5	14.6	11.8	10.7	10.0	9.5
Real monthly wages (average)	-18.5	-18.6	2.0	2.1	3.2	3.5	3.9	4.2	4.2
Savings (percent of GDP)	8.2	15.0	9.1	14.6	14.9	15.8	16.3	17.2	18.2
Private	10.1	13.8	10.4	15.4	15.8	16.2	16.0	16.4	17.2
Public	-1.9	1.2	-1.4	-0.8	-0.9	-0.4	0.3	0.8	1.0
Investment (percent of GDP)	9.9	15.3	10.7	16.1	17.0	17.8	18.3	19.3	20.4
Private	7.5	13.0	8.4	13.1	14.0	14.8	15.0	15.9	17.0
Public	2.4	2.4	2.4	3.0	3.0	3.0	3.3	3.4	3.4
Public finance (percent of GDP)									
General government balance 2/	-4.2	-1.2	-3.7	-3.7	-3.1	-2.6	-2.4	-2.2	-2.1
Overall balance (including Naftogaz operational deficit)	-7.3	-2.1	-3.9	-3.9	-3.1	-2.6	-2.4	-2.2	-2.1
Public and publicly-guaranteed debt	94.4	80.1	92.1	90.3	91.7	85.9	79.4	72.8	67.0
Money and credit (end of period, percent change)									
Base money	27.3	0.8	17.7	13.8	12.8	11.6	10.4	9.9	9.3
Broad money	24.5	3.9	22.5	17.6	18.5	17.6	12.6	12.5	12.0
At program exchange rate	11.8	-7.6	22.9	12.7	20.7	18.9	13.6	13.5	12.9
Credit to nongovernment	15.2	-1.0	14.0	10.2	12.3	12.6	10.9	11.0	12.2
At program exchange rate	-2.9	-19.4	12.6	2.2	11.3	10.4	10.0	10.2	12.1
Velocity	1.7	2.0	1.6	2.0	1.9	1.8	1.8	1.7	1.7
Interbank overnight rate (annual average, percent)	...	21.5	...	...	...	...	...	...	...
Balance of payments (percent of GDP)									
Current account balance	-1.7	-0.3	-1.6	-1.5	-2.1	-2.0	-2.0	-2.1	-2.2
Foreign direct investment	1.6	3.3	2.0	2.4	2.4	3.0	3.0	3.0	2.8
Gross reserves (end of period, billions of U.S. dollars)	18.3	13.3	22.3	16.8	23.7	31.2	31.6	31.6	32.2
Months of next year's imports of goods and services	3.7	3.4	4.2	4.1	5.4	6.5	6.1	5.7	5.3
Percent of short-term debt (remaining maturity)	41.1	45.1	54.0	62.7	82.8	96.9	88.2	87.1	84.7
Percent of the IMF composite metric (float)	65.4	50.8	78.8	65.0	85.7	105.0	102.9	101.3	100.2
Goods exports (annual volume change in percent)	-10.8	-14.3	5.1	-4.1	3.7	6.1	6.4	6.5	6.6
Goods imports (annual volume change in percent)	-23.1	-28.9	5.6	-1.8	4.0	6.2	8.5	7.8	7.9
Goods terms of trade (percent change)	-7.2	-14.4	-0.2	-0.2	0.5	0.8	1.0	1.2	0.8
Exchange rate									
Hryvnia per U.S. dollar (end of period)	...	24.0	...	...	...	...	...	...	...
Hryvnia per U.S. dollar (period average)	...	21.9	...	...	...	...	...	...	...
Real effective rate (deflator-based, percent change)	-10.7	-11.5	-1.8	-3.9	3.5	4.5	3.0	2.7	3.2
Real effective rate (deflator-based, 2010=100)	82.0	81.6	80.6	78.5	81.3	84.9	87.4	89.8	92.6
Memorandum items:									
Per capita GDP / Population (2015): US$2,117 / 43 million									
Literacy / Poverty rate: 100 percent / 2.9 percent									

Sources: Ukrainian authorities; World Bank, World Development Indicators; and IMF staff estimates.
1/ Data based on SNA 2008, exclude Crimea and Sevastopol.
2/ The general government includes the central and local governments and the social funds.

Table 2. Ukraine: General Government Finances, 2014–20 1/

(in billions of Ukrainian hryvnias)

	2014	2015		2016			2017	2018	2019	2020
	Act.	1st Review	Act.	H1 Actual	1st Review	Prog.	Proj.	Proj.	Proj.	Proj.
					Billions of Ukrainian Hryvnia					
Revenue	639.7	808.4	832.9	398.8	898.3	869.6	986.2	1,113.5	1,231.3	1,352.6
Tax revenue	561.2	695.2	701.9	362.7	808.9	766.5	872.0	984.0	1,088.4	1,194.1
Tax on income, profits, and capital gains	115.4	139.4	139.0	89.7	162.1	184.2	211.7	237.9	262.4	290.2
Personal income tax	75.2	95.5	100.0	62.6	112.0	130.9	151.0	169.8	187.2	206.6
Corporate profit tax	40.2	43.9	39.1	27.1	50.1	53.3	60.6	68.1	75.1	83.6
Social security contributions	184.2	189.9	190.4	62.3	228.3	127.8	143.0	160.7	178.8	197.3
Property tax	12.1	14.2	16.0	11.5	16.2	22.4	25.5	28.7	31.6	34.9
Tax on goods and services	201.3	262.8	261.5	161.6	310.6	330.1	371.9	422.8	461.9	504.3
VAT	139.0	185.6	178.5	112.1	218.1	232.1	263.6	300.1	326.3	356.2
Excise	45.1	64.9	70.8	46.2	76.1	91.9	101.7	113.1	125.1	136.0
Other	17.2	12.2	12.3	3.3	16.4	6.1	6.6	9.6	10.6	12.1
Tax on international trade	12.6	36.6	40.3	9.2	25.0	19.9	22.0	24.1	26.6	29.7
Other tax	35.6	52.3	54.7	28.4	66.7	82.0	98.0	109.9	127.0	137.7
Nontax revenue	78.5	113.1	130.9	36.1	89.4	103.0	114.2	129.5	142.9	158.5
Expenditure	710.5	891.1	855.9	414.3	982.7	954.4	1,100.8	1,222.4	1,329.9	1,445.8
Current	693.3	829.4	806.1	400.9	922.0	874.4	999.2	1,115.1	1,210.6	1,317.8
Compensation of employees	162.5	183.0	185.6	104.6	200.7	215.1	238.0	264.2	289.6	316.4
Goods and services	116.9	145.6	146.5	61.7	159.9	154.4	181.5	200.2	213.3	225.9
Interest	52.5	104.5	82.8	47.8	116.2	105.2	115.4	128.0	129.7	138.9
Subsidies to corporations and enterprises	37.1	28.9	25.6	8.5	28.8	19.5	21.3	23.3	25.7	28.4
Social benefits	324.2	365.8	364.0	177.7	416.2	378.5	441.2	497.6	550.4	606.5
Social programs (on budget)	58.3	79.8	75.6	51.3	105.0	102.3	113.9	128.6	140.3	154.5
Pensions	243.6	260.0	265.8	115.2	284.6	252.5	301.1	340.3	379.6	419.6
Unemployment, disability, and accident insurance	22.3	26.0	22.7	11.2	26.6	23.7	26.3	28.7	30.5	32.4
Other current expenditures	0.2	1.6	1.6	0.6	0.2	1.8	1.8	1.8	1.8	1.8
Capital	20.1	46.6	46.7	13.0	53.2	65.5	81.5	89.1	98.3	108.4
Net lending	-2.8	11.1	3.1	0.4	5.3	11.0	12.3	10.9	10.9	9.0
Contingency reserve	0.0	3.9	0.0	0.0	2.3	3.5	7.8	7.3	10.1	10.6
Unidentified measures							30.5	31.0	22.1	14.8
Overall balance	-70.8	-82.7	-23.1	-15.5	-84.4	-84.9	-81.2	-77.1	-76.1	-77.9
Naftogaz balance	-87.3	-61.9	-18.2	27.6	-4.2	-5.1	0.0	0.0	0.0	0.0
General government and Naftogaz balance	-158.1	-144.6	-41.3	12.0	-88.6	-90.0	-81.3	-77.1	-76.1	-77.9
General government financing	70.8	82.7	23.1	15.5	84.4	84.9	81.2	77.1	76.1	77.9
External	37.0	172.0	98.6	6.6	48.5	74.2	50.3	63.2	-45.7	-67.9
Disbursements	94.8	204.6	133.5	12.0	62.5	83.9	76.3	114.2	107.4	90.8
Exceptional Financing		93.4	92.9	0.0	54.2	58.9	89.9	0.0	0.0	42.5
Amortizations	-57.9	-126.0	-127.8	5.4	-68.2	-68.6	-115.9	-51.0	-153.1	-201.1
Domestic (net)	33.9	-89.3	-75.5	8.9	35.9	10.7	31.0	13.9	121.9	145.7
Bond financing 2/	22.5	-12.4	-52.3	34.6	-22.6	-37.4	11.5	-8.0	97.8	119.1
Direct bank borrowing	0.1	0.0	-1.6	-0.9	0.0	0.0	0.0	0.0	0.0	0.0
Deposit finance	10.4	-85.8	-31.2	-25.0	48.0	31.0	0.0	0.0	0.0	0.0
Privatization	0.8	8.8	9.6	0.2	10.5	17.1	19.5	21.9	24.1	26.6
Naftogaz financing	87.3	61.9	18.2	-27.6	4.2	5.1	0.0	0.0	0.0	0.0
Government financing 3/	96.9	50.6	29.9	-1.4	49.3	0.0	37.3	0.0	0.0	0.0
Accumulation of external arrears	1.0	0.0	0.0	0.0	-33.0	0.0	-37.3	0.0	0.0	0.0
Other 4/	-10.6	11.3	-11.8	-26.2	-12.1	5.1	0.0	0.0	0.0	0.0
Other financing	33.6	152.0	45.3	14.3	0.0	166.0	42.0	0.0	0.0	0.0
Bank recapitalization and Deposit Guarantee Fund	26.7	152.0	45.3	14.3	0.0	166.0	42.0	0.0	0.0	0.0
VAT bonds	6.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total financing	191.7	296.6	86.6	2.3	88.6	256.0	123.3	77.1	76.1	77.9
Memorandum items:										
Primary balance	-18.4	21.8	59.7	32.2	31.8	20.3	34.2	50.9	53.6	61.0
Cyclically-adjusted primary balance 5/	0.1	67.8	120.6	...	62.9	55.8	52.2	63.3	61.1	61.3
Structural primary balance 5/ 6/	4.3	49.2	68.7	...	61.6	37.5	52.2	63.3	61.1	61.3
Public and publicly-guaranteed debt	1,116	1,869	1,586	...	2,082	2,059	2,380	2,504	2,555	2,582

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

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

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

6/ The balance in 2015 treats import duty surcharge, part of the NBU profit transfer, January 2016 pension advancement and nonpayment of pensions for working pensioners in civil service as one-off operations. The latter two factors are also part of structural balance calculations for 2016.

Table 2. Ukraine: General Government Finances, 2014–20 (Concluded) 1/

(Percent of GDP)

	2014	2015		2016			2017	2018	2019	2020
	Act.	1st Review	Act.	H1 Actual	1st Review	Prog.	Proj.	Proj.	Proj.	Proj.
Revenue	40.3	40.8	42.1	17.5	39.7	38.1	38.0	38.2	38.3	38.1
Tax revenue	35.4	35.1	35.5	15.9	35.8	33.6	33.6	33.7	33.8	33.7
Tax on income, profits, and capital gains	7.3	7.0	7.0	3.9	7.2	8.1	8.2	8.2	8.2	8.2
Personal income tax	4.7	4.8	5.1	2.7	5.0	5.7	5.8	5.8	5.8	5.8
Corporate profit tax	2.5	2.2	2.0	1.2	2.2	2.3	2.3	2.3	2.3	2.4
Social security contributions	11.6	9.6	9.6	2.7	10.1	5.6	5.5	5.5	5.6	5.6
Property tax	0.8	0.7	0.8	0.5	0.7	1.0	1.0	1.0	1.0	1.0
Tax on goods and services	12.7	13.3	13.2	7.1	13.7	14.5	14.3	14.5	14.4	14.2
VAT	8.8	9.4	9.0	4.9	9.6	10.2	10.2	10.3	10.1	10.0
Excise	2.8	3.3	3.6	2.0	3.4	4.0	3.9	3.9	3.9	3.8
Other	1.1	0.6	0.6	0.1	0.7	0.3	0.3	0.3	0.3	0.3
Tax on international trade	0.8	1.8	2.0	0.4	1.1	0.9	0.8	0.8	0.8	0.8
Other tax	2.2	2.6	2.8	1.2	2.9	3.6	3.8	3.8	3.9	3.9
Nontax revenue	4.9	5.7	6.6	1.6	4.0	4.5	4.4	4.4	4.4	4.5
Expenditure	44.8	45.0	43.2	18.2	43.4	41.8	42.4	41.9	41.3	40.8
Current	43.7	41.9	40.7	17.6	40.8	38.3	38.5	38.2	37.6	37.2
Compensation of employees	10.2	9.2	9.4	4.6	8.9	9.4	9.2	9.1	9.0	8.9
Goods and services	7.4	7.4	7.4	2.7	7.1	6.8	7.0	6.9	6.6	6.4
Interest	3.3	5.3	4.2	2.1	5.1	4.6	4.4	4.4	4.0	3.9
Subsidies to corporations and enterprises	2.3	1.5	1.3	0.4	1.3	0.9	0.8	0.8	0.8	0.8
Social benefits	20.4	18.5	18.4	7.8	18.4	16.6	17.0	17.1	17.1	17.1
Social programs (on budget)	3.7	4.0	3.8	2.2	4.6	4.5	4.4	4.4	4.4	4.4
Pensions	15.4	13.1	13.4	5.0	12.6	11.1	11.6	11.7	11.8	11.8
Unemployment, disability, and accident insurance	1.4	1.3	1.1	0.5	1.2	1.0	1.0	1.0	0.9	0.9
Other current expenditures	0.0	0.1	0.1	0.0	0.0	0.1	0.1	0.1	0.1	0.1
Capital	1.3	2.4	2.4	0.6	2.4	2.9	3.1	3.1	3.1	3.1
Net lending	-0.2	0.6	0.2	0.0	0.2	0.5	0.5	0.4	0.3	0.3
Contingency reserve	0.0	0.2	0.0	0.0	0.1	0.2	0.3	0.3	0.3	0.3
Unidentified measures							1.2	1.1	0.7	0.4
Overall balance	-4.5	-4.2	-1.2	-0.7	-3.7	-3.7	-3.1	-2.6	-2.4	-2.2
Naftogaz balance	-5.5	-3.1	-0.9	1.2	-0.2	-0.2	0.0	0.0	0.0	0.0
General government and Naftogaz balance	-10.0	-7.3	-2.1	0.5	-3.9	-3.9	-3.1	-2.6	-2.4	-2.2
General government financing	4.5	4.2	1.2	0.7	3.7	3.7	3.1	2.6	2.4	2.2
External	2.3	8.7	5.0	0.3	2.1	3.3	1.9	2.2	-1.4	-1.9
Disbursements	6.0	10.3	6.7	0.5	2.8	3.7	2.9	3.9	3.3	2.6
Exceptional Financing		4.7	4.7	0.0	2.4	2.6	3.5	0.0	0.0	1.2
Amortizations	-3.6	-6.4	-6.5	0.2	-3.0	-3.0	-4.5	-1.8	-4.8	-5.7
Domestic (net)	2.1	-4.5	-3.8	0.4	1.6	0.5	1.2	0.5	3.8	4.1
Bond financing 2/	1.4	-0.6	-2.6	1.5	-1.0	-1.6	0.4	-0.3	3.0	3.4
Direct bank borrowing	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Deposit finance	0.7	-4.3	-1.6	-1.1	2.1	1.4	0.0	0.0	0.0	0.0
Privatization	0.1	0.4	0.5	0.0	0.5	0.7	0.8	0.8	0.7	0.8
Naftogaz financing	5.5	3.1	0.9	-1.2	0.2	0.2	0.0	0.0	0.0	0.0
Government financing 3/	6.1	2.6	1.5	-0.1	2.2	0.0	1.4	0.0	0.0	0.0
Accumulation of external arrears	0.1	0.0	0.0	0.0	-1.5	0.0	-1.4	0.0	0.0	0.0
Other 4/	-0.7	0.6	-0.6	-1.1	-0.5	0.2	0.0	0.0	0.0	0.0
Other financing	2.1	7.7	2.3	0.6	0.0	7.3	1.6	0.0	0.0	0.0
Bank recapitalization	1.7	7.7	2.3	0.6	0.0	7.3	1.6	0.0	0.0	0.0
VAT bonds	0.4	0.0	0.0	1.0	0.0	0.0	0.0	0.0	0.0	0.0
Total financing	12.1	15.0	4.4	0.1	3.9	11.2	4.7	2.6	2.4	2.2
Memorandum items:										
Primary balance	-1.2	1.1	3.0	1.4	1.4	0.9	1.3	1.7	1.7	1.7
Cyclically-adjusted primary balance 5/	0.0	3.2	5.7	…	2.7	2.4	2.0	2.1	1.9	1.7
Structural primary balance 5/ 6/	0.3	2.3	3.2	…	2.6	1.6	2.0	2.1	1.9	1.7
Public and publicly-guaranteed debt	70.3	94.4	80.1	…	92.1	90.3	91.7	85.9	79.4	72.8

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/ Government spending on Naftogaz financing and recapitalization, including through T-bills issuance.
4/ Includes external and domestic net disbursements, trade credits, and deposit drawdowns.
5/ For the calculation of these balances, it is asumed that the unidentified measures are on the expenditure side
6/ The balance in 2015 treats import duty surcharge, part of the NBU profit transfer, January 2016 pension advancement and nonpayment of pensions for working pensioners in civil service as one-off operations. The latter two factors are also part of structural balance calculations for 2016.

Table 3. Ukraine: Balance of Payments, 2014–20 1/

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

	2014	2015		2016		2017	2018	2019	2020
	Act.	1st Review	Act.	1st Review	Prog.	Proj.	Proj.	Proj.	Proj.
A. Current account balance	-5.5	-1.5	-0.3	-1.5	-1.3	-2.0	-2.1	-2.3	-2.7
Goods (net)	-8.0	-1.4	-3.3	-1.8	-3.7	-3.9	-3.9	-4.7	-5.1
Exports	50.6	43.6	35.4	46.4	32.6	34.6	37.4	40.6	44.0
Imports	-58.6	-45.0	-38.7	-48.2	-36.4	-38.5	-41.3	-45.3	-49.1
Of which : gas	-6.6	-6.0	-4.4	-4.2	-1.8	-2.3	-2.6	-3.0	-3.4
Services (net)	2.5	0.2	1.6	0.6	2.1	2.2	2.3	2.4	2.4
Receipts	14.9	10.1	12.4	11.2	12.0	12.8	13.5	14.4	15.2
Payments	-12.4	-9.8	-10.8	-10.5	-9.9	-10.5	-11.2	-12.0	-12.8
Primary income (net)	-1.5	-2.0	-1.2	-2.2	-2.1	-2.8	-3.1	-2.9	-3.1
Secondary income (net)	1.5	1.7	2.6	1.8	2.4	2.5	2.7	2.9	3.1
B. Capital account balance 2/	0.1	0.2	0.4	0.0	0.0	0.0	0.0	0.0	0.0
C. Financial account balance	11.7	6.1	4.9	0.0	0.8	-1.9	-6.6	-2.5	-2.6
Direct investment (net) 3/	-0.3	-1.4	-3.0	-1.9	-2.1	-2.3	-3.2	-3.5	-3.8
Portfolio investment (net)	2.7	2.3	2.4	0.2	-0.9	-1.3	-2.8	1.5	0.9
Portfolio investment: assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Portfolio investment: liabilities	-2.7	-2.3	-2.4	-0.2	0.9	1.3	2.8	-1.5	-0.9
Equity	-0.4	-0.1	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Debt securities	-2.3	-2.2	-2.6	-0.2	0.9	1.3	2.8	-1.5	-0.9
General government	0.0	-1.3	-1.8	0.0	0.9	1.0	2.0	-1.8	-1.7
Banks	-0.7	-0.7	-0.6	-0.2	0.0	0.3	0.3	0.1	0.5
Other sectors	-1.6	-0.2	-0.1	0.0	0.0	0.0	0.5	0.2	0.4
Financial derivatives (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment (net)	9.3	5.2	5.5	1.8	3.7	1.6	-0.6	-0.4	0.3
Other investment: assets	0.8	1.2	-1.1	-0.6	-0.6	0.3	0.0	0.0	0.0
Central Bank 4/	-0.4	0.0	-0.1	0.0	0.1	0.0	0.0	0.0	0.0
Banks	-3.0	0.9	0.4	0.0	0.9	0.4	0.0	0.0	0.0
Other sectors	4.2	0.3	-1.5	-0.6	-1.6	0.0	0.0	0.0	0.0
Of which: FX cash outside the banking system 5/	2.7	-1.0	-1.8	-0.6	-1.7	0.0	0.0	0.0	0.0
Of which: Trade credit	0.7	1.4	0.5	0.0	0.2	0.0	0.0	0.0	0.0
Other investment: liabilities	-8.5	-3.9	-6.6	-2.4	-4.4	-1.3	0.6	0.4	-0.3
Central Bank 4/	0.0	0.0	1.5	0.0	-1.2	0.0	0.0	0.0	0.0
General government 6/	-0.4	-0.8	-0.3	-0.8	-0.5	-0.5	-0.6	-0.8	-1.5
Banks 3/	-2.1	-1.6	-4.3	0.3	-1.8	0.4	0.7	0.6	0.5
Other sectors	-6.0	-1.5	-3.5	-1.9	-0.9	-1.3	0.5	0.6	0.6
Loans	-0.3	-3.4	-1.7	-0.9	-1.5	0.2	0.0	0.3	0.3
Trade credit 7/	-5.7	1.8	-1.7	-1.0	0.6	-1.5	0.5	0.4	0.4
D. Errors and omissions	-0.2	0.2	-0.6	0.0	-0.3	0.0	0.0	0.0	0.0
E. Overall balance (A+B-C+D)	-17.3	-7.2	-5.3	-1.6	-2.3	-0.1	4.5	0.1	-0.1
F. Financing	17.1	7.2	5.4	1.6	2.3	0.1	-4.5	-0.1	0.1
Gross official reserves (increase: -)	12.2	-10.7	-6.0	-4.0	-3.3	-6.9	-7.5	-0.4	0.0
Net use of IMF resources	0.9	8.5	5.2	2.5	2.3	4.5	0.9	-1.6	-1.1
Of which: Prospective Fund purchases	4.6	9.9	6.5	2.5	2.3	5.4	2.9	…	…
Official financing 8/	4.0	6.3	3.2	3.1	3.3	2.5	2.1	1.8	1.2
World Bank/IFC	1.5	1.9	1.2	0.4	0.7	0.5	0.5	0.6	0.3
EU	2.1	1.8	0.9	0.7	0.9	0.7	0.0	0.0	0.0
EBRD/EIB/Others	0.5	2.7	1.1	2.0	1.7	1.3	1.6	1.2	0.9
Exceptional financing	0.0	3.1	3.1	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Total external debt (percent of GDP)	95.4	147.7	134.6	144.8	141.3	136.3	129.8	118.4	107.5
Current account balance (percent of GDP)	-4.2	-1.7	-0.3	-1.6	-1.5	-2.1	-2.0	-2.0	-2.1
Goods and services trade balance (percent of GDP)	-3.9	-1.3	-1.9	-1.3	-1.9	-1.8	-1.5	-2.0	-2.1
Gross international reserves	7.5	18.3	13.3	22.3	16.8	23.7	31.2	31.6	31.6
Months of next year's imports of goods and services	1.8	3.7	3.4	4.2	4.1	5.4	6.5	6.1	5.7
Percent of short-term debt (remaining maturity)	20.5	41.1	45.1	54.0	62.7	82.8	96.9	88.2	87.1
Percent of the IMF composite metric	25.1	65.4	50.8	78.8	65.0	85.7	105.0	102.9	101.3
Goods export value (percent change)	-14.5	-21.1	-29.9	6.4	-7.8	6.0	8.1	8.4	8.5
Goods import value (percent change)	-27.9	-27.7	-33.9	7.2	-6.0	5.8	7.3	9.5	8.5
Goods export volume (percent change)	-10.5	-10.8	-14.3	5.1	-4.1	3.7	6.1	6.4	6.5
Goods import volume (percent change)	-25.0	-23.1	-28.9	5.6	-1.8	4.0	6.2	8.5	7.8
Goods terms of trade (percent change)	0.0	-7.2	-14.4	-0.2	-0.2	0.5	0.8	1.0	1.2

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

1/ Based on BPM6 starting from the EFF Second Review. Column "1st Review" is based on BPM5 accounting, but with signs comparable to BPM6.

2/ Official capital transfers are reported below the line.

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

4/ Reflects currency swap transactions.

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

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

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

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

Table 4. Ukraine: Gross External Financing Requirements, 2014–20

(Billions of U.S. dollars)

	2014	2015		2016		2017	2018	2019	2020
	Act.	1st Review	Act.	1st Review	Prog.	Proj.	Proj.	Proj.	Proj.
Total financing requirements	70.3	47.2	48.1	48.7	46.2	41.7	41.9	45.9	50.1
Current account deficit	5.5	1.5	0.3	1.5	1.3	2.0	2.1	2.3	2.7
Portfolio investment	4.2	4.2	4.3	0.2	0.1	0.0	0.2	5.0	5.1
Private	2.3	0.9	0.8	0.1	0.0	0.0	0.2	1.2	1.4
General government	1.8	3.3	3.5	0.1	0.1	0.0	0.0	3.8	3.7
Medium and long-term debt	9.3	11.8	12.3	12.5	12.7	6.2	7.6	6.4	9.7
Private	9.0	11.1	12.0	11.7	12.2	5.7	7.1	5.6	8.2
Banks	2.9	2.8	4.1	2.8	2.7	0.7	1.2	1.6	1.8
Corporates	6.0	8.3	7.8	8.9	9.5	5.0	5.9	4.1	6.3
General government	0.4	0.8	0.3	0.8	0.5	0.5	0.6	0.8	1.5
Short-term debt (including deposits)	25.6	9.7	15.5	13.3	13.2	14.0	14.3	14.0	14.0
Other net capital outflows 1/	0.8	1.2	-1.1	-0.6	0.5	0.3	0.0	0.0	0.0
Trade credit	24.9	18.6	16.9	21.8	18.5	19.2	17.7	18.2	18.6
Total financing sources	53.2	39.8	43.9	47.2	44.6	41.6	46.4	46.0	50.0
Capital transfers 2/	0.1	0.2	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Direct investment, net	0.3	1.4	3.0	1.9	2.1	2.3	3.2	3.5	3.8
Portfolio investment	1.5	1.9	1.9	0.0	1.0	1.3	3.0	3.5	4.3
Private	-0.4	-0.1	0.3	0.0	0.0	0.3	1.0	1.5	2.3
General government	1.9	2.0	1.7	0.0	1.0	1.0	2.0	2.0	2.0
Of which : Eurobond issuance	1.0	2.0	1.0	0.0	1.0	1.0	2.0	2.0	2.0
Medium and long-term debt	7.2	5.9	7.3	10.1	8.9	5.9	7.7	6.2	8.7
Private	7.2	5.9	7.3	10.1	8.9	5.9	7.7	6.2	8.7
Banks	1.7	1.4	1.2	2.8	0.9	0.9	1.5	1.9	2.1
Corporates	5.4	4.5	6.1	7.3	8.0	5.0	6.2	4.3	6.6
General government 2/	…	…	…	…	…	…	…	…	…
Short-term debt (including deposits)	25.0	9.9	14.2	14.3	13.4	14.5	14.3	14.2	14.2
Trade credit	19.2	20.5	17.1	20.9	19.2	17.7	18.2	18.6	19.0
Increase in gross reserves	-12.2	10.7	6.0	4.0	3.3	6.9	7.5	0.4	0.0
Errors and omissions	-0.2	0.2	-0.6	0.0	-0.3	0.0	0.0	0.0	0.0
Total financing needs	5.1	17.9	9.5	5.6	5.1	7.0	3.0	0.2	0.1
Official financing	4.9	14.8	8.3	5.6	5.6	7.0	3.0	0.2	0.1
IMF	0.9	8.5	5.2	2.5	2.3	4.5	0.9	-1.6	-1.1
Prospective purchases	4.6	9.9	6.5	2.5	2.3	5.4	2.9	…	…
Repurchases	3.7	1.4	1.4	0.0	0.0	0.9	2.1	1.6	1.1
Official creditors 3/	4.0	6.3	3.2	3.1	3.3	2.5	2.1	1.8	1.2
World Bank	1.5	1.9	1.2	0.4	0.7	0.5	0.5	0.6	0.3
EU	2.1	1.8	0.9	0.7	0.9	0.7	0.0	0.0	0.0
EBRD/EIB/Others	0.5	2.7	1.1	2.0	1.7	1.3	1.6	1.2	0.9
Exceptional financing	0.0	3.1	3.1	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Gross international reserves	7.5	18.3	13.3	22.3	16.8	23.7	31.2	31.6	31.6
Months of next year's imports of goods and services	1.8	3.7	3.4	4.2	4.1	5.4	6.5	6.1	5.7
Percent of short-term debt (remaining maturity)	20.5	41.1	45.1	54.0	62.7	82.8	96.9	88.2	87.1
Percent of the IMF composite metric 4/	25.1	65.4	50.8	78.8	65.0	85.7	105.0	102.9	101.3
Loan rollover rate (percent) 5/									
Banks	92.5	86.6	87.8	102.2	102.1	106.5	108.9	107.2	106.3
Corporates	95.6	64.3	82.8	97.1	98.5	101.8	100.0	102.3	101.9
Total	93.0	77.3	79.7	99.5	92.6	103.5	103.1	104.2	103.5

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

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

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

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

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

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

Table 5. Ukraine: Monetary Accounts, 2015–20

(Billions of Ukrainian hryvnia unless otherwise noted)

	2015	2016				2017	2018	2019	2020
	Dec.	Mar.	Jun.	Sep.	Dec.				
	Actual	Actual	Actual	Prog.	Prog.	Proj.	Proj.	Proj.	Proj.
Monetary survey									
Net foreign assets	-35	-7	5	30	7	51	220	259	278
(In billions of U.S. dollars)	-1.5	-0.3	0.2	1.1	0.3	1.8	7.8	9.2	9.8
Net domestic assets	1,029	1,014	1,031	1,062	1,162	1,335	1,410	1,575	1,786
Domestic credit	1,503	1,513	1,462	1,499	1,620	1,825	1,975	2,227	2,518
Net claims on government	466	439	453	435	483	550	542	640	759
Credit to the economy	1,013	1,050	989	1,044	1,116	1,254	1,413	1,566	1,739
Domestic currency	465	466	453	456	477	528	558	604	656
Foreign currency	548	585	536	588	639	727	855	962	1,082
(In billions of U.S. dollars)	22.9	22.3	21.0	22.1	23.3	26.1	30.4	34.0	38.0
Other items, net	-474	-499	-431	-438	-458	-490	-565	-652	-732
Broad money	994	1,007	1,036	1,092	1,169	1,386	1,630	1,834	2,064
Currency in circulation	283	270	287	296	306	340	372	408	445
Total deposits	711	737	749	796	863	1,045	1,258	1,426	1,619
Domestic currency deposits	392	380	403	427	460	626	806	957	1,132
Foreign currency deposits	320	357	345	369	403	419	451	469	487
(In billions of U.S. dollars)	13.3	13.6	13.5	13.9	14.6	15.1	16.0	16.6	17.1
Accounts of the NBU									
Net foreign assets	34	32	39	67	59	125	313	369	403
(In billions of U.S. dollars)	1.4	1.2	1.5	2.5	2.1	4.5	11.1	13.1	14.2
Net international reserves	32	27	80	109	102	169	358	414	448
(In billions of U.S. dollars)	1.4	1.1	3.2	4.2	3.7	6.1	12.7	14.6	15.7
Reserve assets	319	334	348	422	462	660	879	894	899
(In billions of U.S. dollars)	13.3	12.7	13.6	15.9	16.8	23.7	31.3	31.6	31.6
Other net foreign assets	2	5	-40	-42	-43	-44	-44	-45	-45
Net domestic assets	302	295	313	294	324	306	168	162	181
Net domestic credit	375	344	331	322	372	370	231	233	260
Net claims on government	363	315	302	306	365	342	284	206	158
Claims on government 1/	414	412	401	388	377	354	296	218	170
Liabilities to government 2/	51	98	99	82	12	12	12	12	12
o/w central gov. deposits									
Net claims on the economy	0	0	0	0	0	0	0	0	0
Net claims on banks	13	29	30	16	6	28	-52	27	102
Other items, net	-73	-49	-18	-28	-48	-64	-63	-71	-78
Base money	336	327	353	361	382	431	481	531	584
Currency in circulation	283	270	287	296	306	340	372	408	445
Banks' reserves	53	58	66	65	77	91	110	123	140
Cash in vault 3/	26	18	20	21	25	30	36	41	47
Correspondent accounts	28	39	45	45	52	61	73	82	93
Deposit money banks									
Net foreign assets	-69	-40	-35	-37	-52	-75	-94	-110	-125
(In billions of U.S. dollars)	-2.9	-1.5	-1.3	-1.4	-1.9	-2.7	-3.3	-3.9	-4.4
Foreign assets	181	206	189	190	183	172	168	162	156
(In billions of U.S. dollars)	7.6	7.9	7.4	7.2	6.7	6.2	6.0	5.7	5.5
Foreign liabilities	250	246	223	232	240	252	267	277	286
Net domestic assets	780	776	783	832	914	1,119	1,351	1,535	1,743
Domestic credit	1,217	1,264	1,232	1,277	1,360	1,581	1,889	2,152	2,433
Net claims on government 4/	104	124	151	128	117	208	258	434	601
Credit to the economy	1,013	1,050	989	1,044	1,116	1,254	1,413	1,566	1,738
Other claims on the economy	23	24	20	20	20	20	20	20	20
Net claims on NBU	77	66	71	84	105	99	197	131	73
Of which : refinancing loans	106	98	85	82	63	56	54	61	131
Other items, net 4/	-438	-488	-449	-445	-445	-462	-537	-617	-690
Banks' liabilities	711	737	748	796	862	1,045	1,257	1,425	1,618
Demand deposits	291	303	...	...	...	...	...	...	...
Savings and time deposits	420	434	...	...	...	...	...	...	...
Memorandum items:	(End of period, percent change unless otherwise noted)								
Base money	0.8	-2.6	5.0	7.5	13.8	12.8	11.6	10.4	9.9
Currency in circulation	-0.1	-4.6	1.6	4.6	8.2	11.2	9.3	9.9	8.9
Broad money	3.9	1.3	4.2	9.8	17.6	18.5	17.6	12.6	12.5
At program exchange rate	-7.6	-2.2	2.2	6.5	12.7	20.7	18.9	13.6	13.5
Credit to the economy	-1.0	3.6	-2.4	3.0	10.2	12.3	12.6	10.9	11.0
At program exchange rate	-19.4	-1.0	-5.0	-2.4	2.2	11.3	10.4	10.0	10.2
Real credit to the economy 5/	-30.9	-27.3	-14.1	-6.1	-2.5	3.6	5.8	4.6	5.7
Credit-to-GDP ratio, in percent	51.2	53.1	46.1	46.2	48.9	48.3	48.5	48.7	49.0
Velocity of broad money, ratio	1.99	1.99	2.07	2.07	1.95	1.87	1.79	1.75	1.72
Money multiplier, ratio	2.96	3.08	2.94	3.02	3.06	3.21	3.39	3.45	3.53

Sources: National Bank of Ukraine; and IMF staff estimates and projections.
1/ Includes Naftogaz recapitalization bonds and DGF financing.
2/ Liabilities include advances for NBU profit transfer and deposits of DGF.
3/ During 2015 only, cash in vault was counted towards required reserves.
4/ Includes claims for bank recapitalization of state owned banks.
5/ Deflated by CPI (eop), at current exchange rates, year-on-year percent change.

Table 6. Ukraine: Financial Soundness Indicators for the Banking Sector, 2014–16

(Percent unless otherwise indicated)

	2014				2015				2016	
	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.
Ownership										
Number of banks, *of which* 1/ 2/	181	174	168	163	148	138	131	120	116	110
Private	174	167	161	156	141	131	124	114	110	104
Domestic	123	116	110	105	95	91	83	73	67	63
Foreign	51	51	51	51	46	40	41	41	43	41
Of which: 100% foreign-owned	19	19	19	19	19	18	18	17	17	17
State-owned	3	3	3	3	3	3	3	3	3	3
State-controlled (inc. in sanation)	4	4	4	4	4	4	4	3	3	3
Foreign-owned banks' share in statutory capital	33.6	32.3	32.1	32.5	30.5	31.1	30.3	42.5	45.2	51.2
Concentration										
Share of assets of largest 10 banks 2/	55.5	57.3	58.8	59.7	63.8	65.9	68.2	70.6	71.4	72.4
Share of assets of largest 25 banks 2/	77.2	79.5	81.0	82.0	83.8	86.1	87.3	88.7	89.7	90.7
Number of bank with assets less than $150 million 2/	95	95	91	103	99	95	92	85	84	77
Capital Adequacy										
Regulatory capital to risk-weighted assets	14.8	15.9	16.0	15.6	8.4	9.0	7.1	12.3	12.0	13.0
Capital to total assets 2/	13.9	13.6	12.7	11.2	6.0	7.6	9.7	8.0	10.3	11.1
Asset Quality										
Credit growth (year-over-year percent change) 3/	21.2	18.0	15.6	12.4	19.3	6.4	0.2	-1.0	-12.1	-6.0
Credit at program exchange rate growth (year-over-year percent change) 3/	5.3	-0.6	-5.9	-15.6	-17.4	-19.0	-21.3	-19.4	-16.5	-13.4
Credit to GDP ratio 2/ 3/	67.9	66.2	65.3	65.3	74.0	62.7	54.2	51.2	50.6	45.5
Change of loan to GDP ratio (year-over-year, percentage points) 2/ 3/	5.8	7.5	-0.9	0.0	6.1	-3.5	-11.1	-14.1	-23.3	-17.1
NPLs to total loans (NBU definition) 2/ 4/	13.3	14.6	16.7	19.0	24.7	24.3	25.6	28.0	29.7	30.4
NPLs to total loans (broader definition) 2/ 5/	26.1	27.7	30.6	32.0	39.7	45.2	45.3	46.4	47.6	48.2
NPLs net of provisions to capital (NBU definition) 2/ 4/	37.6	47.0	55.0	61.1	129.5	94.9	85.8	132.0	105.1	96.3
NPLs net of provisions to capital (broader definition) 2/ 5/	100.2	142.5	153.8	163.9	367.2	348.7	269.8	333.1	259.4	233.6
Specific narrow provisions (percent of NPLs, NBU definition) 4/	60.5	55.2	57.0	63.7	70.2	71.0	68.5	63.8	64.5	64.8
Specific broad provisions (percent of NPLs, broader definition) 5/	36.5	34.6	36.1	42.6	47.9	43.3	44.1	44.8	45.4	46.2
Total specific provisions (percent of total loans, broader definition)	10.5	10.6	11.9	14.6	19.8	20.4	20.8	23.5	24.3	24.9
Foreign Exchange Rate Risk										
Loans in foreign currency to total loans 3/	41.6	42.9	44.2	46.3	55.3	52.0	52.1	54.1	55.7	54.2
Deposits in foreign currency to total deposits	43.4	42.2	41.1	45.6	53.2	47.9	46.5	44.9	48.4	46.1
Foreign currency loans to foreign currency deposits 3/	143.3	153.5	162.2	154.8	168.0	166.1	168.8	171.6	163.9	155.1
Net open FX position to capital 6/	13.4	14.6	23.7	31.7	113.4	98.1	95.2	136.0	134.3	122.5
Net open FX position to regulatory capital (staff estimate) 7/	-18.3	-20.4	-20.9	-32.3	-97.2	-80.6	-86.0	-70.3	-51.2	-40.2
Liquidity Risk										
Liquid assets to total assets	21.6	21.9	24.3	26.4	26.8	27.9	29.9	33.0	35.6	38.4
Customer deposits to total loans to the economy	66.8	66.1	66.1	65.6	61.8	65.3	66.3	70.2	70.2	75.7
Earnings and Profitability										
Return on assets (after tax; end-of-period) 8/	-0.6	0.2	-1.1	-4.1	-22.3	-11.7	-6.7	-5.4	-2.4	-2.1
Return on equity (after tax; end-of-period) 8/	-4.2	1.4	-7.9	-30.5	-285.9	-157.9	-90.4	-70.0	-26.3	-20.6
Net interest margin to total assets	4.6	4.4	4.3	4.2	3.6	4.0	3.9	3.0	3.3	3.5
Interest rate spreads (percentage points; end-of-period)										
Between loans and deposits in domestic currency	7.4	4.5	6.2	6.9	10.8	7.4	8.5	9.7	8.4	8.7
Between loans and deposits in foreign currency	1.9	2.3	2.6	1.9	0.8	2.0	4.0	3.2	3.5	5.0
Between loans in domestic and foreign currency	11.4	8.4	7.5	8.4	16.2	13.4	11.7	12.3	12.4	12.1
Between deposits in domestic and foreign currency	5.9	6.2	3.8	3.3	6.1	8.0	7.2	5.7	7.5	8.4
Number of banks not complying with banking regulations										
Not meeting capital adequacy requirements for Tier I capital 9/	6	5	8	14	29	19	17	6	11	9
Not meeting prudential regulations 9/	28	25	26	31	56	52	39	11	17	11
Not meeting reserve requirements	37	27	33	34	29	18	16	6	11	9

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

1/ Excludes banks under liquidation.

2/ Intra-quarter monthly indicator calculated by staff; latest end of quarter may be preliminary.

3/ Monetary statistics data.

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

5/ Includes also loans classified as substandard.

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

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

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

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

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

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
	Actual	Actual	Projection									
Stock of existing and prospective Fund credit 1/ 2/3/												
In millions of SDRs	3,941	7,701	9,369	12,590	13,206	12,053	11,264	10,001	8,206	6,148	4,090	2,327
In percent of quota	196	561	466	626	656	599	560	497	408	306	203	116
In percent of GDP	4.3	11.9	15.0	18.5	17.6	14.8	12.7	10.3	7.8	5.4	3.4	1.8
In percent of exports of goods and services	8.7	22.5	29.2	37.2	36.3	30.9	26.8	22.1	16.9	11.8	7.3	3.8
In percent of gross reserves	75.8	81.0	78.3	74.4	59.2	53.7	50.2	43.8	34.9	27.2	19.8	12.2
Stock of existing Fund credit 1/ 2/3/												
In millions of SDRs	3,941	7,701	7,701	7,072	5,586	4,433	3,645	2,857	2,069	1,281	493	0
In percent of quota	196	561	383	352	278	220	181	142	103	64	24	0
In percent of GDP	4.3	11.9	12.3	10.4	7.5	5.4	4.1	2.9	2.0	1.1	0.4	0.0
In percent of exports of goods and services	8.7	22.5	24.0	20.9	15.4	11.4	8.7	6.3	4.3	2.4	0.9	0.0
In percent of gross reserves	75.8	81.0	64.4	41.8	25.0	19.7	16.2	12.5	8.8	5.7	2.4	0.0
Stock of prospective Fund credit 1/ 2/3/												
In millions of SDRs	0	0	1,669	5,518	7,620	7,620	7,620	7,144	6,137	4,867	3,597	2,327
In percent of quota	0	0	83	274	379	379	379	355	305	242	179	116
In percent of GDP	0.0	0.0	2.7	8.1	10.2	9.4	8.6	7.3	5.8	4.3	3.0	1.8
In percent of exports of goods and services	0.0	0.0	5.2	16.3	20.9	19.5	18.1	15.8	12.6	9.3	6.4	3.8
In percent of gross reserves	0.0	0.0	13.9	32.6	34.2	33.9	34.0	31.3	26.1	21.6	17.4	12.2
Obligations to the Fund from existing and prospective drawings 2/3/												
In millions of SDRs	0	125	91	900	1,811	1,492	1,140	1,578	2,049	2,235	2,152	1,798
In percent of quota	0	9	5	45	90	74	57	78	102	111	107	89
In percent of GDP	0.0	0.2	0.1	1.3	2.4	1.8	1.3	1.6	1.9	2.0	1.8	1.4
In percent of exports of goods and services	0.0	0.4	0.3	2.7	5.0	3.8	2.7	3.5	4.2	4.3	3.8	3.0
In percent of gross reserves	0.0	1.3	0.8	5.3	8.1	6.6	5.1	6.9	8.7	9.9	10.4	9.4
Obligations to the Fund from existing drawings 2/3/												
In millions of SDRs	0	125	73	713	1,480	1,046	609	622	658	707	761	495
In percent of quota	0	9	4	35	74	52	30	31	33	35	38	25
In percent of GDP	0.0	0.2	0.1	1.0	2.0	1.3	0.7	0.6	0.6	0.6	0.6	0.4
In percent of exports of goods and services	0.0	0.4	0.2	2.1	4.1	2.7	1.4	1.4	1.4	1.4	1.4	0.8
In percent of gross reserves	0.0	1.3	0.6	4.2	6.6	4.7	2.7	2.7	2.8	3.1	3.7	2.6
Obligations to the Fund from prospective drawings 2/3/												
In millions of SDRs	0	0	18	187	332	446	531	956	1,391	1,528	1,391	1,303
In percent of quota	0	0	1	9	16	22	26	48	69	76	69	65
In percent of GDP	0.0	0.0	0.0	0.3	0.4	0.5	0.6	1.0	1.3	1.4	1.1	1.0
In percent of exports of goods and services	0.0	0.0	0.1	0.6	0.9	1.1	1.3	2.1	2.9	2.9	2.5	2.2
In percent of gross reserves	0.0	0.0	0.2	1.1	1.5	2.0	2.4	4.2	5.9	6.8	6.7	6.8

Source: IMF staff estimates.

1/ End of period.
2/ Repayment schedule based on repurchase obligations and charges.
3/ For 2015 Ukraine's old quota of SDR 1,372 million applies. Ukraine's new quota of SDR 2011.8 million became effective in February 2016.

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

	Amount of purchase			
Availability date	Millions of SDRs	Millions of US$ 1/	Percent of quota 2/	Conditions
March 11, 2015	3,546.000	4,872.00	258.45	Board approval of extended arrangement
June 15, 2015 3/	1,182.100	1,650.00	86.16	First review and end-March 2015 performance criteria
September 15, 2015	716.110	1,000.00	52.19	Second review and end-December 2015 performance criteria
November 15, 2016	952.487	1,330.88	47.35	Third review and end-September 2016 performance criteria
February 15, 2017	1,418.479	1,985.90	70.51	Fourth review and end-December 2016 performance criteria
May 15, 2017	952.487	1,333.59	47.35	Fifth review and end-March 2017 performance criteria
August 15, 2017	952.487	1,333.56	47.35	Sixth review and end-June 2017 performance criteria
November 15, 2017	525.570	735.83	26.12	Seventh review and end-September 2017 performance criteria
February 15, 2018	525.570	735.42	26.12	Eight review and end-December 2017 performance criteria
May 15, 2018	525.570	735.67	26.12	Ninth review and end-March 2018 performance criteria
August 15, 2018	525.570	736.08	26.12	Tenth review and end-June 2018 performance criteria
November 15, 2018	525.570	736.08	26.12	Eleventh review and end-September 2018 performance criteria
Total	12,348	17,185	614	

Source: IMF staff estimates.

1/ For 2015–18, the average USD/SDR rates used in this table are: 1.402, 1.397, 1.400, and 1.400, respectively.

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

3/ The second purchase took place on August 4, 2015.

Annex. Debt Sustainability Analysis

Under the policy and financing package supporting the extended arrangement under the EFF, including the recent completion of the debt operation as per terms consistent with program targets, and conditional to a no material intensification of the conflict in the East, Ukraine's public debt is assessed as sustainable with high probability. Public debt is projected to remain above the 70 percent of GDP high-risk benchmark in the debt sustainability framework in the near term. Debt is embarked on a downward path thereafter—reaching below 70 percent of GDP by 2021—driven by the successful completion of the debt operation, sustained fiscal adjustment, including the elimination of quasi-fiscal losses in the energy sector, growth recovery and renewed efforts to advance structural reforms, new momentum in privatization, and real exchange rate appreciation. The projected downward trajectory of Ukraine's public debt remains subject to considerable risks, particularly from growth and real exchange rate shocks, or a regress to historical levels of the primary fiscal balance due to failure to implement and sustain the programmed fiscal adjustment, and larger-than-expected contingent liabilities emanating from the banking sector. The average gross financing needs during the program and post-program period are forecast to remain well below 15 percent of GDP,[1] mitigating the risks associated with the high debt level. The shift in the composition of debt towards official debt with longer maturity and lower cost also lessens the risks. The external DSA continues pointing to significant solvency concerns as external debt would peak at 145 percent of GDP in 2016, with the historical scenario showing unsustainable dynamics, but the presence of significant non-financial foreign assets provides a buffer for maintaining external debt service while a sustained reduction in current account deficits and the ongoing process of voluntary private debt restructuring would put external debt on a downward path. Though external debt would remain on a downward trend, growth and real exchange rate shocks could keep it more elevated than under the baseline.

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

[1] In 2016, the high-risk threshold of 15 percent of GDP is breached by a small amount. However, the 2016 program is fully financed, and about half of the financing needs relate to the provisioning for potential bank recapitalization costs.

A. Key assumptions in the DSA

2. The macroeconomic framework has been updated to reflect the most recent developments.

- **Real GDP growth**. The 2015 recession proved to be deeper than initially expected (with an output decline of 9.9 percent compared to 9 percent at the time of the first review). Real GDP growth is projected at 1.5 percent in 2016, slightly lower than anticipated earlier reflecting a worse external environment. Thereafter, growth is expected to reach 4 percent by 2020, instead of 2018 as previously projected at the time of the first review.

- **Exchange rate**. With the end of the commodity super cycle, Ukraine's terms of trade worsened. While the exchange rate came under temporary pressure, it has subsequently stabilized around UAH24–25 per dollar. It is expected that relatively contained current account deficits and the resumption of capital inflows would support a small real exchange rate appreciation over the medium term.

- **Inflation**. Inflation (measured by the GDP deflator) peaked at 38 percent in 2015 (as projected in the first review). Inflation is projected to recede quickly in 2016 to about 13½ percent, as economic stabilization takes hold and also helped by lower fuel and gas prices, and then gradually decrease over the medium term to a steady state of about 6 percent.

- **Fiscal and Naftogaz deficits**. The 2015 fiscal targets were met with a substantial margin. The general government budget deficit was reduced to 1.2 percent of GDP, well below the program target of 4.2 percent and the 2014 outturn of 4.5 percent, reflecting higher revenues due to higher-than-anticipated inflation during the first half of the year, as well as lower interest payments as a result of the debt operation. Naftogaz's deficit declined to less than 1 percent of GDP in 2015, compared to the program target of 3.1 percent and losses of about 5.5 percent in 2014, mainly as a result of lower gas import price and volume. The combined fiscal deficits during the projection period remain in line with program targets. The cyclically-adjusted primary surplus of the general government is projected to remain from 2017 onwards at about 2 percent of potential GDP, representing a considerable adjustment of around 24.5 percentage points of GDP over 2013. As noted at the time of EFF approval, this path is ambitious in the context of previous fiscal performance in Ukraine (an average cyclically-adjusted primary deficit of 2.2 percent of GDP over 2004–13), and international comparisons (well above the 75th percentile of historical primary balance adjustments in countries with IMF-supported programs, Figure 2), though it is not unprecedented.

3. Other identified debt-creating/reducing flows.

- **Banking system support**. Fiscal costs in 2015 amounted to 2.3 percent of GDP, below a projection of about 8 percent of GDP, with the bulk of it used to support DGF to pay insured deposits. As a result of the changes in the macroeconomic framework and the recently completed bank diagnostics for the 39 largest banks, public funds for banking system support have been rephased and revised up to 7.3 and 1.6 percent of GDP for 2016 and 2017, respectively.

- **Naftogaz recapitalization**. Recapitalization bonds for a total of 1.5 percent of GDP were issued in 2015, well below the support of 6.1 percent of GDP provided in 2014. No more fiscal support to Naftogaz is envisaged during the medium term for operational and investment purposes. However, the program assumes that Naftogaz would need an additional 1.4 percent of GDP of financing support to clear the stock of arrears with Gazprom in 2017.[2]

- **Issuance of guaranteed debt**. The authorities only issued 0.6 percent of GDP of new guarantees in 2015, well below the programmed envelope of 1.5 percent of GDP. For 2016, the program targets 1.2 percent of GDP for new guarantees, with the bulk earmarked to support official financing to Naftogaz (WB's loan guarantee for US$500 million and IFC's loan for US$200 million). The program assumes that the issuance of new guarantees over the medium term would be limited to 0.3 percent of GDP per year due to the expected reduced demand brought about by the privatization/corporatization of SOEs and improved finances of Naftogaz as envisaged under the program.

- **Privatization proceeds**. Proceeds for 0.5 percent of GDP were received in 2015, above the receipts in the past two years (about 0.1 percent of GDP per year). For the period 2016–20, the program assumes 0.8 percent of GDP per year below the historical average of 1.1 percent during 2004–14—supported by the renewed efforts to advance the privatization agenda.[3]

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

[3] It is expected that Odessa Portside Plant would be privatized in late 2016. Thereafter, the authorities intend to launch the privatization of some of the country's regional energy distributors by end-2016 and for power generator Centrenergo by end-March 2017.

4. **Debt operation**. The authorities have successfully completed the restructuring of nearly all external liabilities included in the perimeter of the debt operation in line with the financing and debt objectives of the program. The external liabilities eligible for the debt operation—which included public and publicly-guaranteed debt (sovereign and sovereign-guaranteed Eurobonds, city of Kyiv Eurobonds, and guaranteed commercial loans) and SOE debt (non-guaranteed Eurobonds and loans) for a total nominal value of US$22.3 billion (see text table below)—were restructured following different debt exchange offers tailored to the specific circumstances at hand.

Original Schedule of Amortization of Instruments Included in the Debt Operation 1/

(Billions of U.S. dollars)

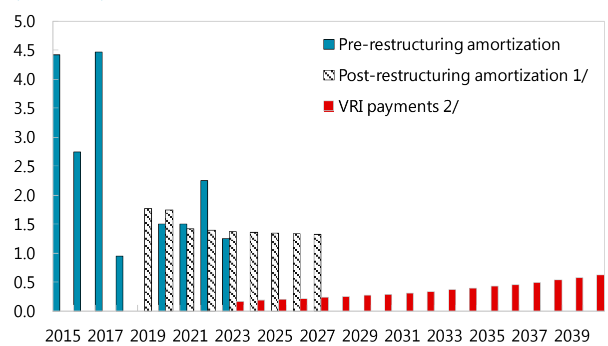
	2015	2016	2017	2018	2019	2020	2021	2022	2023	Total
Total	5.1	3.6	4.6	2.6	0.0	1.5	1.5	2.3	1.3	22.3
Eurobonds	5.1	3.4	4.4	2.3	0.0	1.5	1.5	2.3	1.3	21.7
Sovereign Eurobonds 2/	4.4	2.6	3.3	0.0	0.0	1.5	1.5	2.3	1.3	16.7
Guaranteed Eurobonds 3/	0.0	0.0	1.1	0.7	0.0	0.0	0.0	0.0	0.0	1.8
Non-guaranteed SOEs Eurobonds 4/	0.8	0.8	0.0	1.6	0.0	0.0	0.0	0.0	0.0	3.2
Loans	0.0	0.2	0.2	0.3	0.0	0.0	0.0	0.0	0.0	0.6
Guaranteed commercial loans 5/	0.0	0.2	0.1	0.3	0.0	0.0	0.0	0.0	0.0	0.5
Non-guaranteed SOEs loans 4/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1

Source: Ministry of Finance.
1/ Eligible instruments were announced in Cabinet Resolution No. 318 on April 4.
2/ Includes Eurobonds issued by the City of Kyiv amounting to US$0.6 billion.
3/ Includes Eurobonds issued by the SOE "Financing of Infrastructural Projects" in 2010, 2011, and 2012.
4/ Includes Eurobonds and external loans of SOEs: Ukreximbank, Oschadbank, and Ukrzaliznytsya.
5/ Includes external loans of SOEs: Ukravtodor and Yuzhnoye State Design Office.

- **Restructuring of public and publicly-guaranteed debt**. The restructuring of PPG external debt (amounting to US$19.1 billion, including the US$3 billion of debt held by Russia) was aimed at contributing to the three targets of the debt operation (see the chart on the pre- and post-restructuring amortization schedule). It consisted of three completed debt exchange offers:

Restructuring of Public and Publicly-guaranteed Debt

(USD billion)



Source: IMF staff calculations.
1/ It does not incorporate yet the repayment of the bond held by Russia under negotiations.
2/ Under constant real GDP growth of 4 percent.

i. **Sovereign and sovereign-guaranteed Eurobonds**. The exchange offer on US$18 billion bonded debt launched on September 22, 2015 attracted broad creditor participation, with the exception of Russia who holds a US$3 billion Eurobond. Collective action clauses (CACs) were triggered in all participating bonds leading to no holdouts but Russia. The restructuring terms included a 20 percent haircut on the outstanding nominal amount; 0 percent haircut on capitalized accrued interest; issuance of nine broadly equally-sized new bonds maturing as bullets during 2019–27 (versus 2015–23 under existing instruments);[4] coupon of 7.75 percent for all bond series (versus a pre-exchange average of 7.2 percent); and a value recovery instrument (i.e., GDP-growth warrant), providing potential upside to bondholders during 2021–40 (capped at 1 percent of GDP during 2021–25) if nominal GDP is above US$125.4 billion and real GDP growth is above 3 percent during this period.[5] The NPV haircut (excluding VRI payments) at the exit yield of 10 percent is estimated at about 28 percent. The Ukrainian authorities are engaged in finding a solution on the restructuring of the Russian-held bond. In this regard, the DSA assumes that a restructuring agreement would be reached involving no nominal haircut and a repayment schedule and coupon rate consistent with the financing and debt objectives of the program.

ii. **City of Kyiv Eurobonds**. On November 23, 2015, the City of Kyiv launched an exchange offer aimed at restructuring its Eurobonds due 2015 and 2016 amounting to about US$0.6 billion. While the 2016 bond attracted broad creditor participation and as such triggered its CAC, the 2015 bond fell short of the needed participation (with only 59.5 percent tendering the old bond and ultimately receiving the new bonds). A moratorium remains in place for the holdouts on the 2015 bond of the amount of US$101 million. The restructuring terms, which upgraded a non-guaranteed debt to a sovereign liability, mirrored those offered for sovereign Eurobonds, with the exception of the nominal haircut (25 percent) and maturity extension (only taps of the 2019 and 2020 new sovereign bonds). The resulting NPV haircut at the exit yield of 10 percent was therefore somewhat higher than the sovereign offer (about 35 percent).

iii. **Guaranteed commercial loans**. In April 2016, the Ministry of Finance, together with SOEs Ukravtodor and the Yuzhnoye State Design Office, reached an agreement with Sberbank of Russia and Citibank, respectively, on the restructuring of sovereign-guaranteed loans to the

[4] All creditors received a ratable amount of all nine series of new bonds, subject to the priority allocation whereby creditors holding the September and October 2015 Eurobonds were provided only 2019 new bonds. The latter therefore reduced the amount of new bonds due 2019 available to other creditors and increased their share of new bonds due 2020–27.

[5] VRI payments are calculated according to the following formula:

If $3\% \leq \textit{Real GDP Growth}_{t-2} < 4\%$,

VRI payment = $15\% \times \text{UAH Nominal GDP}_{t-3} \times (1+\text{GDP Deflator}_{t-2}) \times (\text{Real GDP Growth}_{t-2} - 3\%)$

If $\textit{Real GDP Growth}_{t-2} \geq 4\%$,

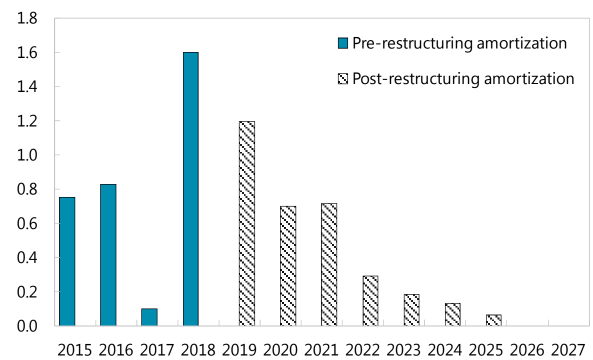
VRI payment = $15\% \times \text{UAH Nominal GDP}_{t-3} \times (1+\text{GDP Deflator}_{t-2}) \times 1\% +$

$40\% \times \text{UAH Nominal GDP}_{t-3} \times (1+\text{GDP Deflator}_{t-2}) \times (\text{Real GDP Growth}_{t-2} - 4\%)$

aforementioned SOEs. The two commercial banks hold 80 percent of the restructured US$0.5 billion guaranteed loans. The restructuring terms, which converted the guaranteed loans into sovereign bonds, also mirrored those offered for sovereign Eurobonds with the exception of the nominal haircut (25 percent) and maturity extension (tap of the 2019 new sovereign bond).

- **Restructuring of SOE debt**. The restructuring of selected SOEs external liabilities (amounting to US$3.3 billion) was primarily aimed at contributing to the financing target of US$15 billion during the program period, but also has helped in limiting the size of contingent liabilities that otherwise could have spilled over to the sovereign at the time when SOEs are in the early stages of repairing their balance sheets from the deep economic crisis. All deals, involving Eurobonds and external commercial loans of Ukreximbank, Oschadbank and Ukrainian Railways, attracted broad creditor participation leading to no holdouts. The restructuring terms extended the maturity of the outstanding debt without nominal haircut and with repayments starting gradually after the program period (see the chart below on the pre and post-restructuring amortization schedule), and increased coupon rates by an average of 100 basis points.

Restructuring of SOE Debt
(USD billion)



Source: IMF staff calculations.

- **Financing and debt targets**. Assuming the completion of the restructuring of the remaining external liabilities as per expected terms, the debt operation implemented by the authorities is consistent with the financing and debt objectives set under the program. In particular, two of the program targets are assessed to be met, while the targeted debt-to-GDP ratio in 2020 is expected to be exceeded by a small margin.

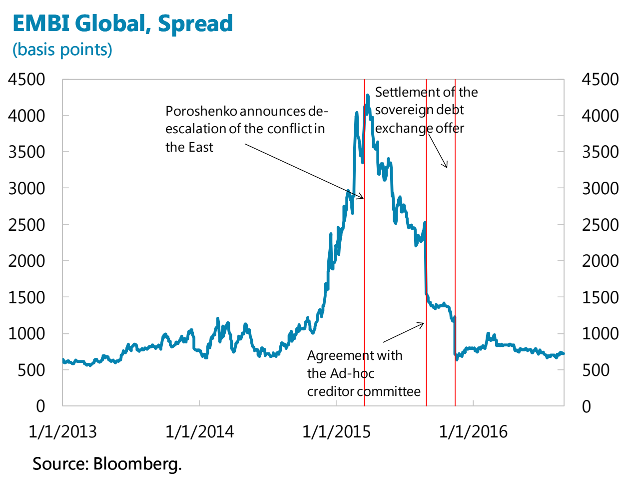
    i. **Target 1**. The restructuring of PPG debt, together with the rescheduling of SOEs external liabilities included in the debt operation, is estimated to reduce Ukraine's external debt service payments by US$15.7 billion during the program period (compared to the program target of US$15 billion).

    ii. **Target 2**. Under the macroframework applicable at the time of the sovereign debt exchange offer, staff projected that the debt/GDP ratio in 2020 would reach 72.1 percent, exceeding the ceiling of 71 percent by a small amount. Under the revised macroframework, the breach increases slightly with the debt-to-GDP ratio by 2020 projected at 72.7 percent, mainly as a result of the higher nominal depreciation. In any case, the debt to GDP ratio would fall under 70 percent of GDP by 2021.

iii. **Target 3**. The average gross financing needs (GFNs), taking into account the payments to creditors arising from the VRI under the baseline, is projected at about 9.5 percent of GDP during 2019–25, with GFNs remaining below 12 percent in any single year, thus meeting target 3.[6] The debt operation has also reduced notably GFNs during the program period (2015–18), from an average of 18 percent of GDP to 12 percent.

5. Official financing. Multilateral and bilateral financing is provided at concessional rates (tied to Euribor/Libor and fixed annual rates below 2 percent, respectively), with loans amortizing in the range of 10–20 years (with multilaterals granting a grace period of about five years). IMF lending under the current program is calibrated to be on EFF terms.

6. Market access. Evidence points to an early return to market access in past successful pre-emptive debt operations with time to re-access at about three years from the start of the operation. Ukraine's time to re-access markets after its 1998 debt restructuring was also about three years. It is then expected that by late 2017 Ukraine would be able to re-access international capital markets (5-year bonds at the yield of 9 percent), supported the improved debt profile as a result of the successful completion of the debt operation (reflected in the notable reduction in sovereign risk to pre-crisis levels) and assuming a continued de-escalation of the conflict in the East. Low gross financing needs during the post-program period, well below the high-risk benchmark in the debt sustainability framework, would help ensure the needed continuous market access.



Source: Bloomberg.

[6] Target 3 is also met on expected basis after incorporating the impact of growth volatility on the VRI payments. The latter was estimated using Monte Carlo simulation based on 10,000 random draws after modeling real GDP growth as an AR(1) process subject to (non-skewed and skewed) normally distributed shocks, centered at potential GDP growth, and assuming Ukraine's growth volatility as the median growth volatility of EMs during 1970–2014 (4 percent).

B. Public Sector DSA

7. The coverage of public debt in this DSA includes: (i) central government direct debt (including domestic debt held by the NBU amounting to 20 percent of GDP at end-2015); (ii) domestic and external government-guaranteed debt (loans and bonds) extended to SOEs (with 25 percent of total guaranteed debt (excluding IMF) having been called and currently served by the central government at end-2015); (iii) debt of local governments; and (iv) NBU's liabilities to the IMF. It does not contain non-guaranteed SOEs' domestic and external liabilities.

Public and Publicly-Guaranteed Debt 1/

	2014			2015		
	Billions of U.S. dollars	Percent of GDP	Percent of total	Billions of U.S. dollars	Percent of GDP	Percent of total
Public and publicly-guaranteed debt	70.8	71.2	100.0	66.1	80.1	100.0
Domestic debt	31.4	31.6	44.4	22.2	26.9	33.6
Direct debt in UAH	25.4	25.5	35.9	18.8	22.8	28.4
Direct debt in FX	4.3	4.3	6.0	2.5	3.1	3.9
Guaranteed debt	1.8	1.8	2.5	0.9	1.1	1.4
External debt	39.4	39.6	55.6	43.9	53.2	66.4
External direct debt	31.4	31.6	44.3	34.9	42.3	52.8
Multilateral 2/	10.8	10.9	15.3	13.3	16.2	20.2
of which: IMF budget support 3/	5.4	5.5	7.7	7.1	8.5	10.7
Bilateral 4/	2.7	2.7	3.8	3.8	4.6	5.7
Sovereign Eurobonds	17.3	17.4	24.4	17.6	21.4	26.7
Local government Eurobonds 5/	0.6	0.6	0.8	0.1	0.1	0.2
External-guaranteed debt	8.0	8.0	11.3	9.0	10.9	13.6
of which: IMF loans to NBU 3/	2.2	2.2	3.1	5.4	6.6	8.2
of which: Eurobonds	1.8	1.8	2.6	0.0	0.0	0.0
of which: Commercial loans	3.3	3.3	4.6	2.8	3.4	4.3

Source: Ministry of Finance.

1/ Public sector is defined as general government, including local government debt and NBU's debt to IMF.

2/ Includes IMF, WB, EBRD, and EIB.

3/ Includes the 2009 SDR allocation.

4/ Includes EU.

5/ Issued by the City of Kyiv.

8. Baseline projections indicate that the debt ratio would fall below 70 percent of GDP by 2021 (Figure 3). Debt reached 80 percent of GDP at end-2015, a jump of 8 percentage points from 2014, driven mainly by another bout of exchange rate depreciation and a deep recession. The increase in debt was contained as a result of the nominal haircut accepted by private creditors, significant fiscal over-performance, delayed IFIs disbursements, reduced issuance of new guarantees, and lower Naftogaz recapitalization needs and banking system support than envisaged at the time of the first review. Another round of nominal depreciation due to BOP pressures from the end of the commodity super cycle, catch up of IFIs disbursements, and rephased and higher fiscal costs for bank restructuring and resolution would lead public debt to increase in the near term. Thereafter, sustained fiscal adjustment and growth recovery (as well as real exchange rate appreciation and privatization receipts) would underpin the gradual convergence of debt to below 70 percent of GDP by 2021.

9. A heat map and fan charts indicate that Ukraine faces significant risks to debt sustainability (Figure 1). Even after the successful completion of the debt operation and assuming full program implementation, significant uncertainty remains, heightened by the sudden deterioration of the external environment. However, risks stemming from the elevated debt level are mitigated by reduced gross financing needs, projected to average 12 and 9.5 percent during and after the program period, respectively. The fan charts illustrate the possible evolution of the debt-to-GDP ratio over the medium term, based on both a symmetric and asymmetric distribution of risks. In the former, upside and downside risks to the main macro variables are treated as equally likely, while in the latter shocks to the primary balance and REER are restricted to be negative to reflect the limits of fiscal effort over what is envisaged under the baseline fiscal adjustment plan and the possibility of continued depreciation. The asymmetric fan chart therefore shows that risks to the debt outlook are skewed upward if the envisaged fiscal consolidation and FX market stabilization fall short of expectations. Risks to the debt profile have improved. While still high, the EMBIG spread has come down from its peak of 4,312 basis points in 2015:Q1 to an average below 800 basis points in 2016:Q2, reflecting the de-escalation of the conflict in the East and the successful completion of the debt operation (see text chart). The share of public debt held by non-residents is high (2/3 of total debt), but the shift from private to official creditors is reducing the implied risks (the share of official debt in total debt increased by 12 percentage points in 2015, see text table on 2014–15 PPG debt). Short-term debt ratios are very low, and the share of foreign currency debt is projected to decline in the coming years, mitigating rollover and exchange rate risks.

10. Stress tests continue pointing to a number of considerable risks to the debt outlook, with the balance of risk mostly tilted to the downside. The projected decline in public debt remains fragile, vulnerable to lower growth, continued exchange rate depreciation, and contingent liabilities emanating from the banking system. Under a growth shock, entailing lower growth by one historical standard deviation in 2017–18 (to -5.1 percent and -4.6 percent, respectively), which leads in turn to sizable deteriorations of the primary balance to deficits of 2.5 and 5.8 percent, respectively, the debt-to-GDP ratio reaches 117 percent in 2018. A real exchange rate shock replicating half the size of the FX pressures Ukraine experienced in 2014 (with the nominal exchange rate moving from 27.5 in 2016 to 45.9 in 2017) would push the debt ratio to 116 percent of GDP by 2017. The combined macro-fiscal shock, an aggregation of the shocks to real growth, interest rate, primary balance and exchange rate, produces unsustainable dynamics, sending debt above 160 percent of GDP in 2018. The contingent liabilities shock highlights the risk of a further deterioration of banking sector health and associated higher fiscal costs. Its impact is mitigated by the program buffer embedded under the baseline for bank restructuring and resolution costs. By imposing a large associated shock to growth (10 percentage points below the baseline in 2017–18) and given the resulting deterioration in the primary balance together with an increase in interest rates, under the contingent liabilities shock debt peaks at 112 percent of GDP in 2018. A scenario based on Ukraine's historical variables (with flat growth and primary deficit at -0.8 and 1.7 percent, respectively) leaves debt very high and flat at about 98 percent of GDP. However, the implementation of the EFF-supported program, especially the targeted fiscal adjustment and structural reforms to facilitate growth recovery, should prevent it from occurring.

11. **The shocks scenarios point to risks related to larger-than-expected financing needs, including to support the banking sector**. While the debt operation has reduced gross financing needs, in 2016 the 15 percent threshold would be marginally exceeded on the back of revised bank recapitalization needs, which leaves the classification in the heat map at high risk. Under stress tests, only the combined shock has a meaningful impact on gross financing needs, raising it to an average of more than 20 percent of GDP during the projection period.

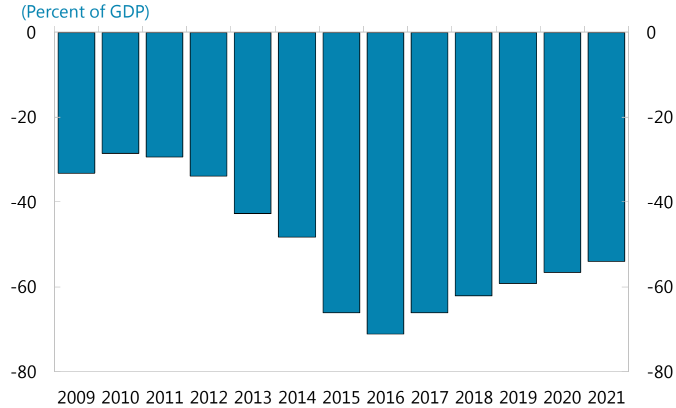
C. External Sector DSA

12. **Baseline projections suggest that external debt would drop by about 50 percentage points of GDP by 2021, while remaining high**. Gross external debt would peak at 145 percent of GDP in 2016 from slightly below 100 percent in 2014 before declining to about 100 percent of GDP by end-2021. The medium-term sustainability of external debt is underpinned by the significant external adjustment, with the trade balance of goods and services moving from a deficit of close to 9 percent of GDP in 2013 to an average of about 2 percent by 2020. Its downward path is also supported by the impact of the debt operation through the primary income balance in the current account and the expected sustained recovery of non-debt creating capital inflows. Moreover, the non-financial sector maintains significant foreign currency assets (at 99 percent of GDP by end-2015, see the net IIP text table below), which reduces their net exposure to external shocks and helps

maintain external debt service.[7] The latter is reflected in the significant difference between external debt and the net IIP, with the latter projected to contract from 66 percent of GDP in 2015 to close to 50 percent in the medium term. Finally, corporations continue to be engaged in voluntary debt restructuring/refinancing operations, with increasing amounts of principal repayments being deferred (5.8 percent of GDP in 2015 versus 1.7 percent in 2014).

Net International Investment Position

(Percent of GDP)



Source: IMF staff calculations.

Net IIP, 2015

(Percent of GDP)

Net IIP	-66
Assets	146
FDI	11
Portfolio	0
Other investment	119
Reserve assets	15
Liabilities	212
FDI	76
Portfolio	34
Other investment	102
Memo:	
Liquid financial assets	9
Liquid non-financial assets	99

Source: IMF staff calculations.

13. **However, external debt dynamics are subject to downside risks due to macroeconomic shocks or a quick reversal of the recent external adjustment** (Figure 6). A slower-than-expected resumption of export growth, due to a protracted impact of the war-induced supply shocks, delays in finding suitable markets for products previously targeted to CIS trading partners, and/or the sudden worsening of the external environment could undo the adjustment of the current account deficit at the time when imports start to respond to growth recovery. If the current account deteriorates on average by about 1 percent of GDP per year compared to the baseline, the external debt ratio would increase by about 8 percent of GDP by 2021. External debt dynamics are significantly affected by growth shocks. A half historical standard deviation shock from the growth path under the baseline, about 3 percentage points lower growth on average per year, increases the external debt ratio by about 21 percentage points of GDP by 2021. Reduced FDI due to confidence effects from a prolongation or intensification of the conflict in the East would also significantly affect external debt dynamics, with a sizable upward shift in the debt adjustment path. The historical scenario, with main macro variables constant at their 10-year historical average, generates unsustainable dynamics. The latter is the result of a permanent state of recession (with real GDP

[7] For the first time since data is available starting in 2000, the non-financial sector reduced its stock of liquid foreign assets by about 2.5 percent of GDP in 2015.

contracting 0.8 percent per year) and significant and sustained FX pressures (with the GDP deflator in U.S. dollar terms flat at just 2.9 percent). It thus remains critical to accelerate the reform process to enhance the business climate and non-price competitiveness in order to attract the needed FDI to support growth and expand and diversify the export base.

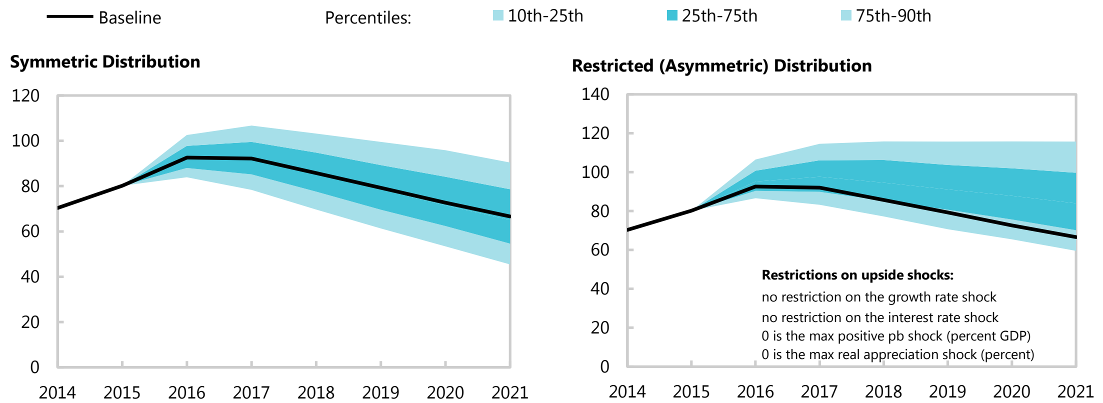
Annex. Figure 1. Ukraine: Public DSA Risk Assessment

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

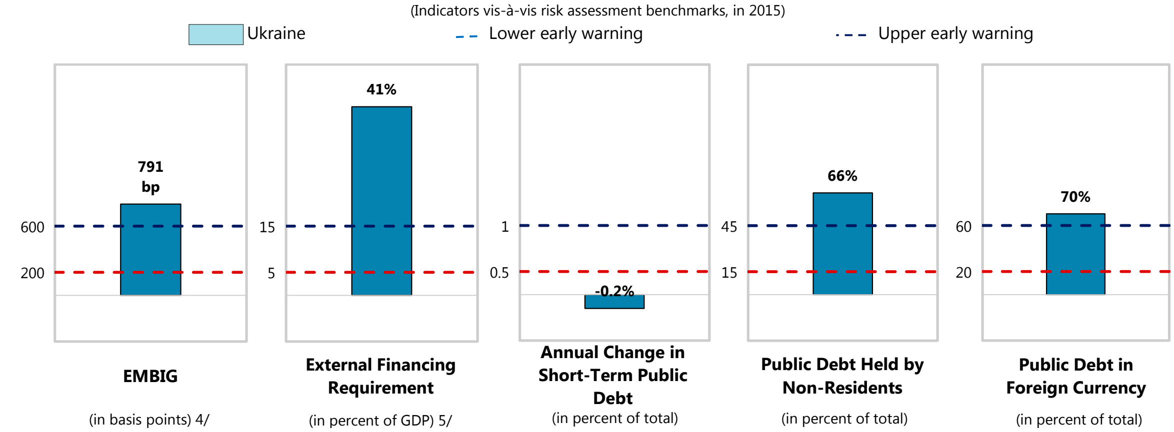
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2015)



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.

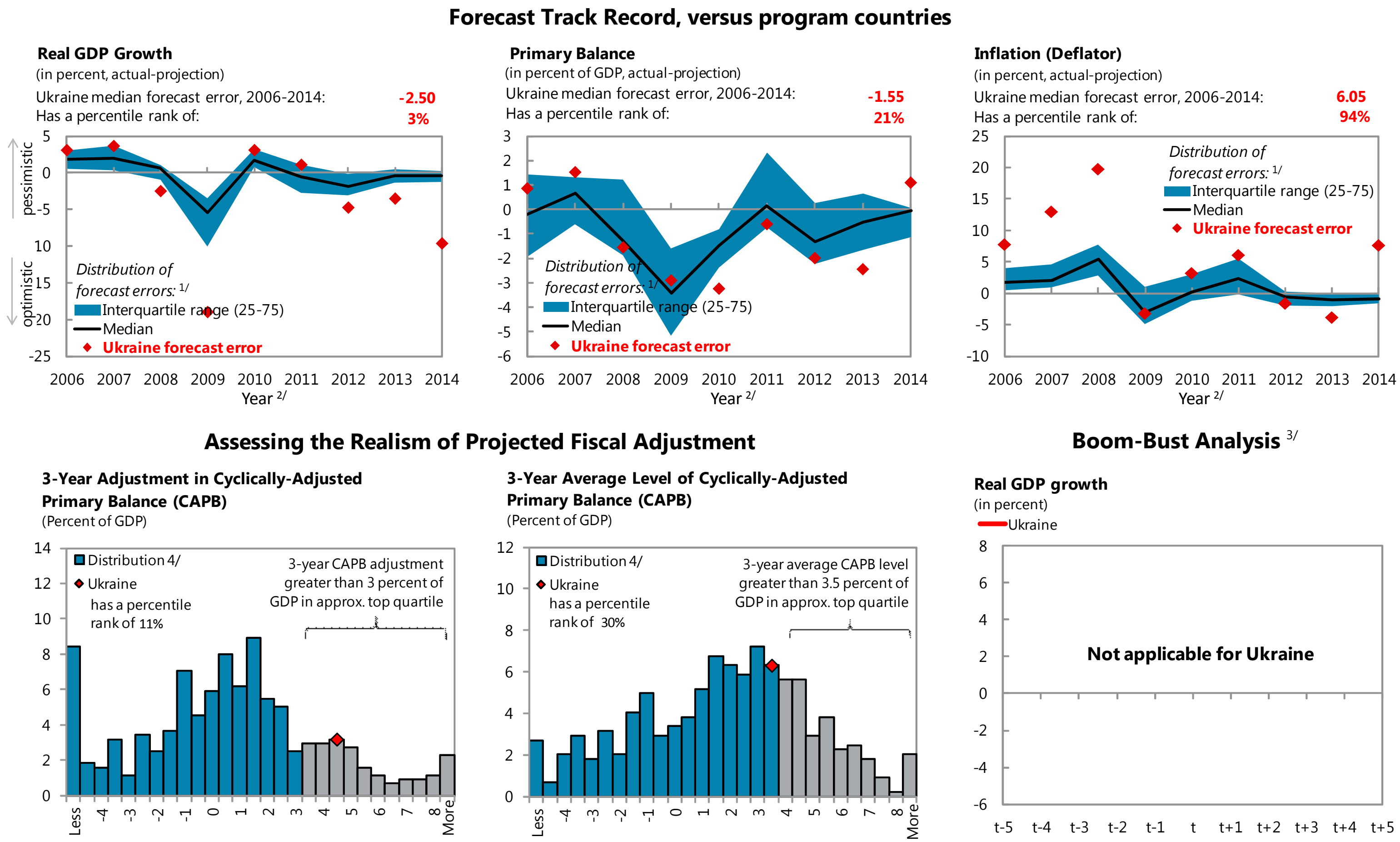
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, 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, 03-Mar-16 through 01-Jun-16.

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

(in percent of GDP unless otherwise indicated)

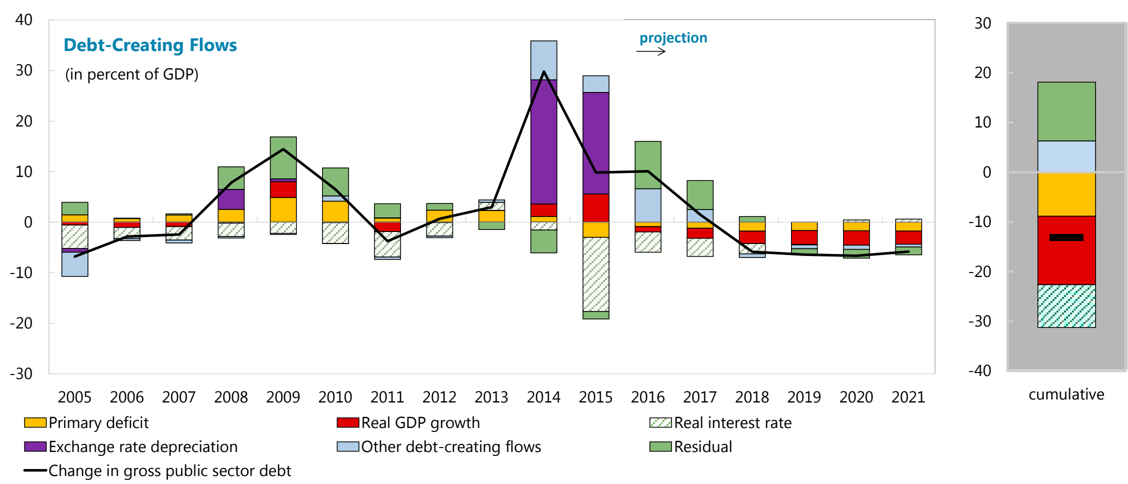
Debt, Economic and Market Indicators [1]

	Actual			Projections					
	2005-2013 [2]	2014	2015	2016	2017	2018	2019	2020	2021
Nominal gross public debt	28.1	70.3	80.1	90.2	91.7	85.8	79.4	72.8	67.0
Of which: guarantees	6.5	9.7	12.0	15.3	19.5	19.1	16.9	14.4	12.3
Public gross financing needs	7.6	19.7	11.7	16.2	10.6	9.4	11.8	10.5	8.4
Real GDP growth (in percent)	1.3	-6.6	-9.9	1.5	2.5	3.0	3.5	4.0	4.0
Inflation (GDP deflator, in percent)	15.9	15.9	38.4	13.5	11.0	9.0	6.5	6.0	6.0
Nominal GDP growth (in percent)	17.6	8.3	24.7	15.2	13.8	12.3	10.3	10.3	10.3
Effective interest rate (in percent) [4]	6.9	10.7	8.6	8.0	6.8	6.8	6.7	6.9	7.2

As of August 29, 2016		
Sovereign Spreads		
EMBIG (bp) 3/		721
5Y CDS (bp)		757
Ratings	Foreign	Local
Moody's	Caa3	Caa3
S&Ps	B-	B-
Fitch	CCC	CCC

Contribution to Changes in Public Debt

	Actual			Projections							
	2005-2013	2014	2015	2016	2017	2018	2019	2020	2021	cumulative	debt-stabilizing primary balance [9]
Change in gross public sector debt	1.8	29.8	9.8	10.1	1.5	-5.8	-6.4	-6.6	-5.8	-13.2	-2.1
Identified debt-creating flows	-0.8	34.3	11.3	0.7	-4.2	-7.0	-5.2	-4.9	-4.3	-25.0	
Primary deficit	2.3	1.2	-3.0	-0.9	-1.2	-1.7	-1.6	-1.7	-1.7	-8.9	
Primary (noninterest) revenue and grants	42.2	40.3	42.1	38.1	38.0	38.2	38.3	38.1	38.3	229.0	
Primary (noninterest) expenditure	44.5	41.5	39.1	37.2	36.8	36.4	36.6	36.4	36.6	220.1	
Automatic debt dynamics [5]	-2.5	25.5	11.0	-5.0	-5.6	-4.5	-2.8	-2.4	-2.0	-22.4	
Interest rate/growth differential [6]	-2.9	0.9	-9.1	-5.0	-5.6	-4.5	-2.8	-2.4	-2.0	-22.4	
Of which: real interest rate	-2.7	-1.5	-14.7	-4.0	-3.6	-2.0	-0.1	0.5	0.6	-8.6	
Of which: real GDP growth	-0.2	2.5	5.6	-1.0	-2.0	-2.5	-2.8	-2.9	-2.6	-13.8	
Exchange rate depreciation [7]	0.4	24.5	20.1	…	…	…	…	…	…	…	
Other identified debt-creating flows	-0.6	7.7	3.3	6.6	2.5	-0.7	-0.8	-0.8	-0.6	6.3	
Net Privatization Proceeds (negative)	-1.0	-0.1	-0.5	-0.7	-0.7	-0.7	-0.7	-0.7	-0.5	-4.2	
Bank and Naftogaz recapitalization	0.4	7.8	3.8	7.3	3.1	0.0	0.0	0.0	0.0	10.4	
Other adjustments	0.0	0.0	0.0	0.1	0.2	0.0	0.0	-0.1	-0.1	0.2	
Residual, including asset changes [8]	2.6	-4.5	-1.5	9.4	5.7	1.1	-1.2	-1.7	-1.5	11.8	



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

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

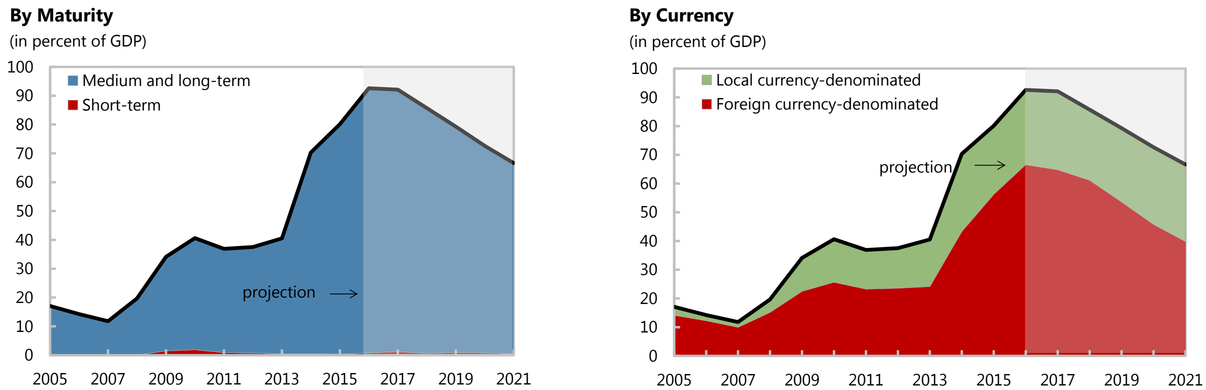
7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

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

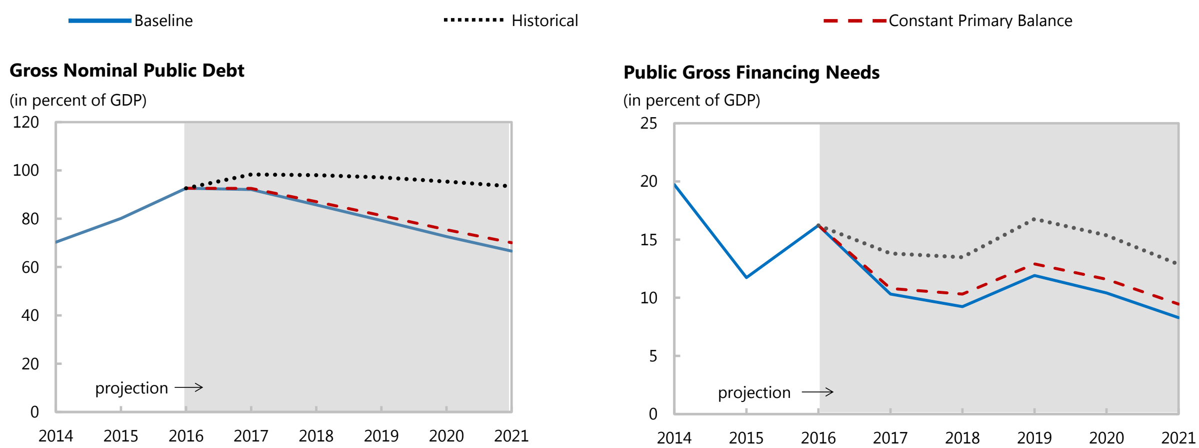
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

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

Composition of Public Debt



Alternative Scenarios



Underlying Assumptions

(in percent)

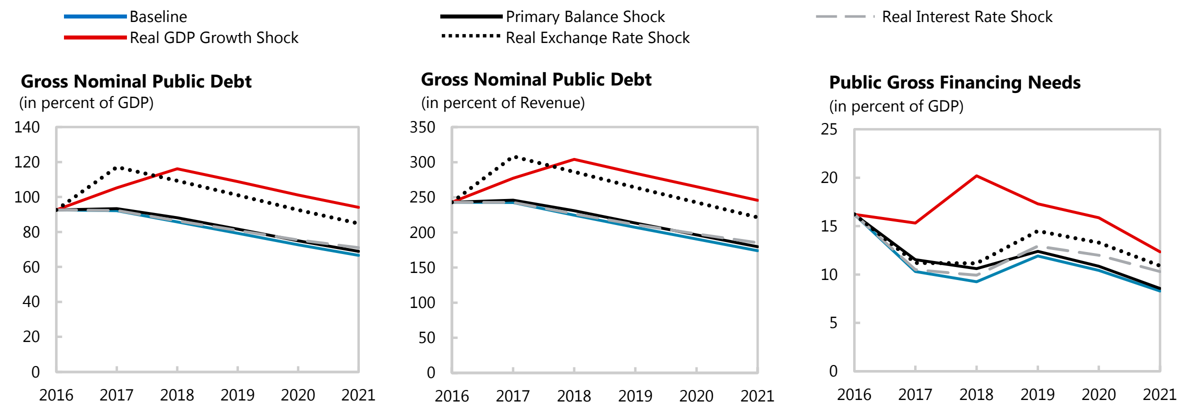
Baseline Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	1.5	2.5	3.0	3.5	4.0	4.0
Inflation	13.5	11.0	9.0	6.5	6.0	6.0
Primary Balance	0.9	1.2	1.7	1.6	1.7	1.7
Effective interest rate	7.9	6.6	6.8	6.7	6.9	7.2
Constant Primary Balance Scenario						
Real GDP growth	1.5	2.5	3.0	3.5	4.0	4.0
Inflation	13.5	11.0	9.0	6.5	6.0	6.0
Primary Balance	0.9	0.9	0.9	0.9	0.9	0.9
Effective interest rate	7.9	6.7	6.7	6.6	6.9	7.2

Historical Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	1.5	-0.8	-0.8	-0.8	-0.8	-0.8
Inflation	13.5	11.0	9.0	6.5	6.0	6.0
Primary Balance	0.9	-1.7	-1.7	-1.7	-1.7	-1.7
Effective interest rate	7.9	6.7	5.7	4.7	4.1	3.7

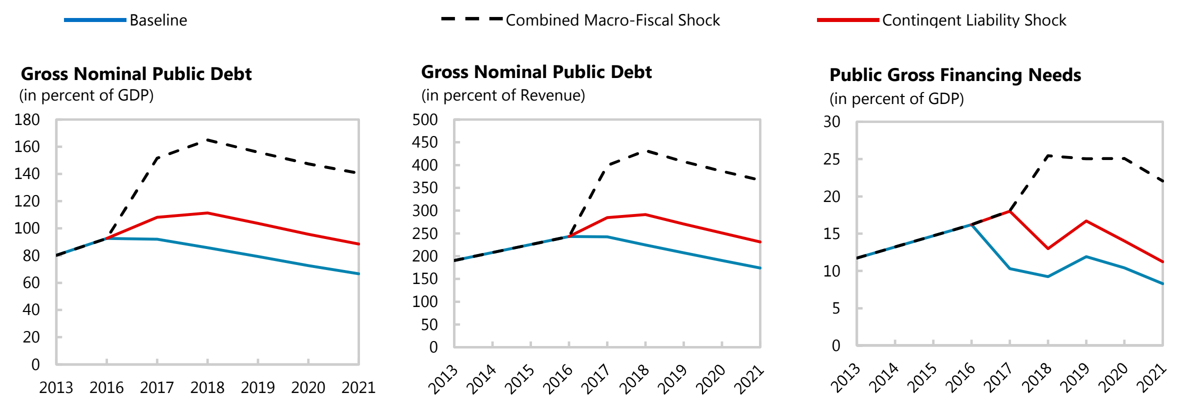
Source: IMF staff.

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

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

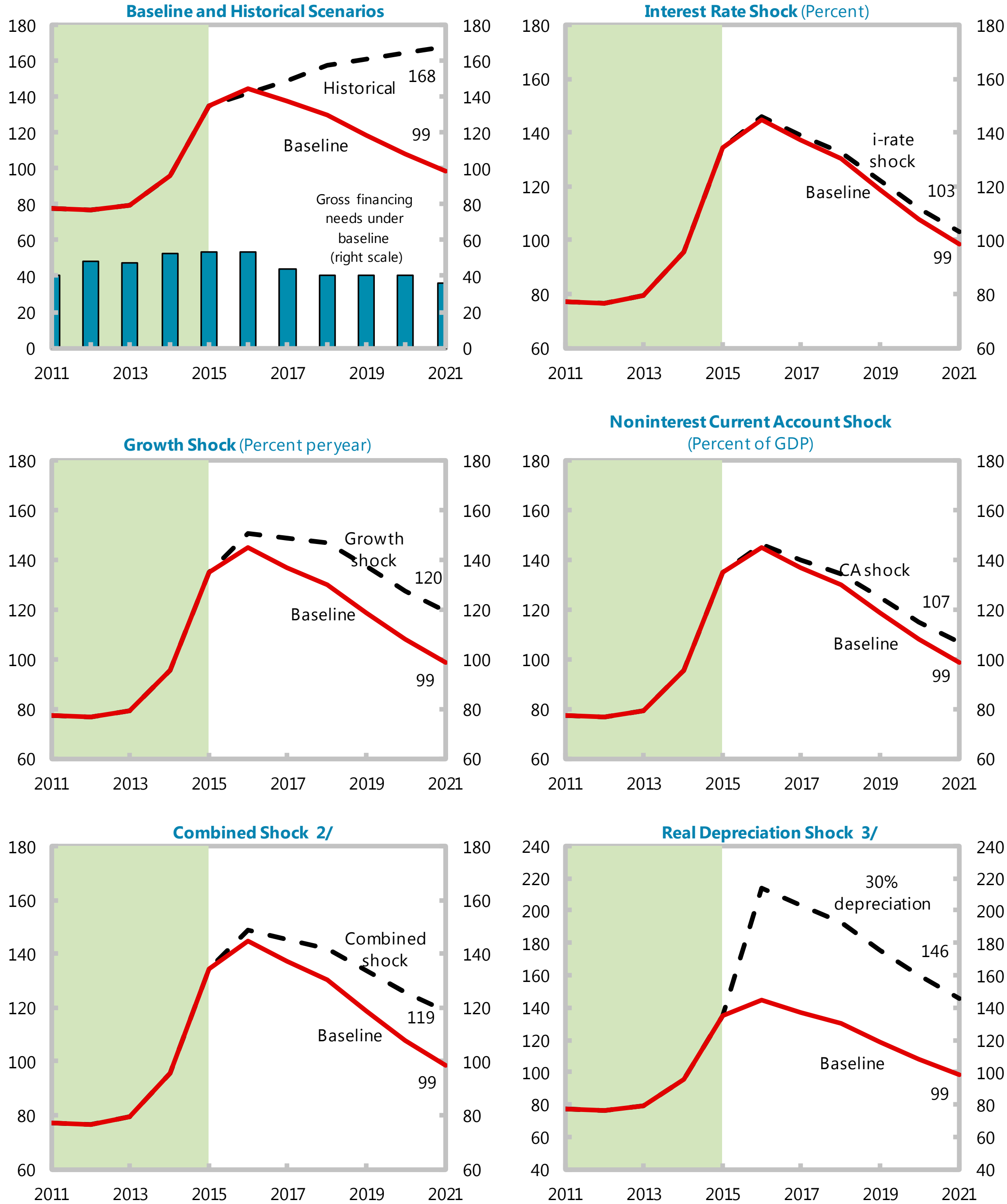
Primary Balance Shock	2016	2017	2018	2019	2020	2021
Real GDP growth	1.5	2.5	3.0	3.5	4.0	4.0
Inflation	13.5	11.0	9.0	6.5	6.0	6.0
Primary balance	0.9	0.1	0.7	1.6	1.7	1.7
Effective interest rate	7.9	6.7	6.8	6.7	6.9	7.2
Real Interest Rate Shock						
Real GDP growth	1.5	2.5	3.0	3.5	4.0	4.0
Inflation	13.5	11.0	9.0	6.5	6.0	6.0
Primary balance	0.9	1.2	1.7	1.6	1.7	1.7
Effective interest rate	7.9	6.7	7.5	8.0	9.1	10.2
Combined Shock						
Real GDP growth	1.5	-5.1	-4.6	3.5	4.0	4.0
Inflation	13.5	9.1	7.1	6.5	6.0	6.0
Primary balance	0.9	-2.5	-5.8	1.6	1.7	1.7
Effective interest rate	7.9	8.4	6.2	7.1	8.3	9.4

Real GDP Growth Shock	2016	2017	2018	2019	2020	2021
Real GDP growth	1.5	-5.1	-4.6	3.5	4.0	4.0
Inflation	13.5	9.1	7.1	6.5	6.0	6.0
Primary balance	0.9	-2.5	-5.8	1.6	1.7	1.7
Effective interest rate	7.9	6.7	6.9	7.2	7.4	7.6
Real Exchange Rate Shock						
Real GDP growth	1.5	2.5	3.0	3.5	4.0	4.0
Inflation	13.5	27.2	9.0	6.5	6.0	6.0
Primary balance	0.9	1.2	1.7	1.6	1.7	1.7
Effective interest rate	7.9	8.4	6.0	6.0	6.4	6.8
Contingent Liability Shock						
Real GDP growth	1.5	-5.1	-4.6	3.5	4.0	4.0
Inflation	13.5	9.1	7.1	6.5	6.0	6.0
Primary balance	0.9	-4.8	1.7	1.6	1.7	1.7
Effective interest rate	7.9	7.2	6.8	6.6	6.9	7.2

Source: IMF staff.

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

(Percent of GDP, unless otherwise indicated)

Ukraine: Program External Debt Sustainability Framework, 2013–21

(Percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing non-interest current account 6/
	2013	**2014**	**2015**			**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	
Baseline: external debt	79.1	95.4	134.6			141.3	136.2	129.8	118.4	107.5	98.4	-6.5
Change in external debt	2.5	16.3	39.1			6.7	-5.0	-6.5	-11.4	-11.0	-9.0	
Identified external debt-creating flows (4+8+9)	4.6	32.2	40.8			-2.9	-3.5	-4.8	-5.2	-5.2	-4.5	
Current account deficit, excluding interest payments	3.2	-1.5	-5.8			-5.8	-5.1	-4.9	-4.0	-3.5	-3.0	
Deficit in balance of goods and services	8.7	3.9	1.9			1.9	1.8	1.5	2.0	2.1	2.4	
Exports	45.5	49.4	52.8			51.2	49.7	48.5	47.9	47.3	46.5	
Imports	54.2	53.3	54.7			53.1	51.4	50.1	50.0	49.4	48.9	
Net non-debt creating capital inflows (negative)	-2.9	0.1	-3.5			-2.4	-2.4	-3.0	-3.0	-3.0	-2.8	
Automatic debt dynamics 1/	4.4	33.6	50.2			5.3	4.0	3.1	1.8	1.3	1.2	
Contribution from nominal interest rate	6.0	5.3	6.1			7.3	7.2	6.8	6.0	5.7	5.2	
Contribution from real GDP growth	0.0	7.0	13.8			-2.1	-3.3	-3.8	-4.2	-4.3	-3.9	
Contribution from price and exchange rate changes 2/	-1.7	21.2	30.3			...	...	...	...	...	...	
Residual, including change in gross foreign assets (2-3) 3/	-2.1	-15.8	28.6			9.6	-1.5	-1.6	-6.1	-5.7	-4.5	
External debt-to-exports ratio (percent)	173.9	193.0	254.9			275.7	274.2	267.3	247.0	227.2	211.7	
Gross external financing need (billions of U.S. dollars) 4/	85.5	69.9	48.1			46.2	41.7	41.9	45.9	50.1	50.1	
Percent of GDP	47.6	52.8	53.1			53.0	43.8	39.9	40.0	40.0	36.6	
Scenario with key variables at their historical averages 5/				10-Year Historical Average	10-Year Standard Deviation	138.5	147.6	157.6	161.0	164.0	168.1	3.8
Key macroeconomic assumptions underlying baseline												
Real GDP growth (percent)	0.0	-6.6	-9.9	-0.8	7.6	1.5	2.5	3.0	3.5	4.0	4.0	
GDP deflator in U.S. dollars (change in percent)	2.2	-21.1	-24.1	2.9	19.0	-5.1	6.6	6.8	5.5	5.2	5.2	
Nominal external interest rate (percent)	8.0	5.0	4.3	7.1	1.4	5.3	5.6	5.5	5.1	5.2	5.3	
Growth of exports of goods and services (U.S. dollar terms, percent)	-9.2	-19.9	-27.0	3.9	25.9	-6.5	6.0	7.5	7.8	7.9	7.5	
Growth of imports of goods and services (U.S. dollar terms, percent)	-6.7	-27.5	-29.9	5.9	31.0	-6.4	5.9	7.1	9.0	8.2	8.2	
Current account balance, excluding interest payments	-3.2	1.5	5.8	0.6	3.1	5.8	5.1	4.9	4.0	3.5	3.0	
Net non-debt creating capital inflows	2.9	-0.1	3.5	4.4	2.2	2.4	2.4	3.0	3.0	3.0	2.8	

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. Ukraine: Letter of Intent

Kyiv, September 1, 2016

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

Dear Ms. Lagarde:

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

2. Notwithstanding the exceptionally difficult situation in Ukraine—with the unresolved conflict in the East—we have made steadfast efforts to implement policies under the EFF-supported program reflecting our strong commitment to economic adjustment and reforms. Economic activity continued to expand in the first half of 2016, with real GDP growing in two consecutive quarters for the first time since 2012 and after a deep and painful recession. Inflation is falling sharply. In terms of policies, we have taken measures to support the much-needed fiscal consolidation, restore financial sector stability, start to combat corruption, and improve the business climate.

3. Our actions ensured that all but three performance criteria (PC) were met, as well as six out of eleven structural benchmarks set for the period through end-May 2016. Regarding the missed PCs, despite increased efforts by the National Bank of Ukraine (NBU) to purchase foreign exchange in the market following the introduction of foreign exchange auctions, the (adjusted) end-December 2015 PC for the NBU's net international reserves (NIR) was missed, due largely to a more adverse external environment. Also, the continuous PCs on the non-accumulation of external debt payment arrears and the non-imposition of exchange restrictions were not observed. While we have successfully completed the restructuring of 13 out of 14 sovereign bonds, we could not reach an agreement yet on the restructuring of the remaining bond, on which we have fallen into arrears. However, we are engaged in negotiations on the restructuring of this bond consistent with the objectives of our program, aiming to achieve debt sustainability. Further, we imposed an exchange restriction arising from the prohibition of foreign exchange purchases for payments of imports where goods had been cleared by customs before January 1, 2014 and where one of the contractual parties changed. This measure has now been eliminated. Regarding the five missed structural

benchmarks, we have taken the following corrective actions: (i) to correct for the delay in establishing a specialized anticorruption prosecution function to oversee NABU's investigations, we have appointed the head of the anticorruption prosecutors and two deputies prior to the completion of this review and have made further improvements to secure a sustainable, fair and balanced selection framework going forward by amending the Law on the Prosecutor's office. Meanwhile, NABU has become operational as planned; (ii) we request to reset the end-December 2015 benchmark on pension reforms. While we remain committed to advancing reforms to restore the viability of our pension system—which has gained urgency with the reduction in social security contributions—we need some additional time to build the necessary support within society. As a first step, we have reduced the list of occupations eligible for early retirement prior to the completion of this review; (iii) we have been making steady progress on the structural benchmark on orders of payment and garnishment, however, the legal process is taking more time and we request to reset this benchmark to end-September 2016, while also expanding its scope; (iv) we request to reset the end-March 2016 structural benchmark on corporate insolvency and credit enforcement regimes to end-September 2016, which has been reformulated to focus on insolvency law reform; and (v) we request to replace the partially met benchmark on improving the targeting of household utility subsidies with a new benchmark for end-September 2016 to fine tune the program to ensure that the 2016 utility subsides will remain within the budget ceiling. We have also ensured further progress in improving the financial health of our banking system prior to the completion of this review.

4. Our policy efforts will continue to focus on entrenching macroeconomic stability and setting the stage for robust and inclusive growth so critical for the Ukrainian people. This includes actions to achieve low and stable inflation within a flexible exchange rate regime, gradually restore NBU's international reserves to adequate levels, rehabilitate the banking system, strengthen external and fiscal positions further, and improve competitiveness and the business climate through far-reaching structural reforms. To ensure continued progress toward fiscal sustainability, our parliament has also adopted the government budget for 2016 broadly consistent with program targets, together with supporting changes to our tax legislation and expenditure reforms prior to the completion of this review. Given the risks to the budget from the more adverse external environment, the challenge in administering the range of changes implemented in late 2015, and the need for a further fiscal adjustment of about 1.5 percent of GDP in 2017, our fiscal effort will focus on adopting permanent measures to raise revenue collection and reduce expenditures in line with the fiscal objectives of the program. In this respect, we will refrain from revenue-reducing tax policy changes not fully offset by permanent measures and our efforts will aim primarily at improving the efficiency and equity of our tax system, including by broadening the tax base (particularly by eliminating existing exemptions

and refraining from granting new ones) and strengthening revenue administration. Also, to eliminate the quasi-fiscal deficit of Naftogaz—earlier than previously envisaged—prior to the completion of this review, we have adopted the necessary decisions to further increase gas and heating tariffs as of May 1, and July 1, 2016, respectively, to bring them fully to cost-recovery levels.

5. We remain committed to continuing our efforts to enhance transparency and address corruption, speed up privatization, and improve governance of state-owned enterprises, as described in the attached document. In this regard, we have adopted legislation and launched an effective and transparent asset declaration requirement for high-level officials. We have also stepped up our efforts by adopting several key pieces of legislation, including amendments to the Law on Privatization and a new Law on Corporate Governance of State Property.

6. On the basis of steps that we have already taken and commitments for the period ahead, we request completion of the second review, and a disbursement in the amount of SDR 716.110 million. Given the delay in completing this review as well as in the implementation of some of the measures under the program, we expect the third review under the arrangement to be based on the end-September 2016 performance criteria, and request that the remaining amounts be allocated over the next nine purchases, as set out in Table 3. In addition, we request waivers of nonobservance of the end-December 2015 performance criterion on the net international reserves of the NBU, the continuous performance criterion on the non-accumulation of external debt payment arrears, as well as the continuous performance criterion on the non-imposition of restrictions on the making of payments and transfers for current international transactions. Furthermore, we also request the completion of the financing assurances review.

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

Yours sincerely,

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

Attachment I. Ukraine: Memorandum of Economic and Financial Policies

I. Recent Economic Developments and Outlook

1. **While the 2015 recession proved deeper than expected, the economy has now turned the corner**. While real GDP contracted by 15.8 percent in the first half of 2015, an economic recovery gradually took hold in the second half of the year. Real GDP growth, quarter-on-quarter, expanded by 0.5 percent in the fourth quarter supported by recovering consumer and investor confidence, a pick-up in investment activity, and a de-escalation of the conflict in the East. The recovery in the latter part of the year mitigated the overall real GDP decline to close to 10 percent in 2015. The economic revival has continued into 2016, with real GDP growth accelerating to 1.3 percent year-on-year in the second quarter. Agriculture, retail sales, and construction have all posted strong gains over this period. Despite a worsened external environment—including lower commodity prices that affect some of our key export products—we still expect positive growth in 2016, but we have revised our forecast slightly downward to 1.5 percent.

2. **Inflation continues to sharply decelerate**. After the increase in the price level caused by the large exchange rate depreciation and energy price increases early last year, headline inflation has rapidly dropped to 7.9 percent in July because of exchange rate stabilization, prudent monetary policy, and weak demand. Going forward, inflation is expected to pick up on account of administered price adjustments, some strengthening in demand, and waning base effects.

3. **The overall balance of payments was broadly in line with the program in 2015, but is expected to worsen in 2016, reflecting a more adverse external environment**. While exports continue to underperform—owing to feeble demand in trading partners and low commodity prices—imports have also been compressed as a result of the weaker economy, the hryvnia depreciation, and lower gas imports. As a result, the current account of the balance of payments is estimated to have recorded a small deficit of 0.3 percent of GDP in 2015, about 1½ percentage points of GDP less than envisaged at the time of the first program review. The private financial account has been broadly in line with projections, reflecting the ongoing restructuring of private sector debt. Gross reserves increased to over US$13 billion at end-December 2015, more than double the level at the start of the program, but below our projections, mostly as a result of delays in the disbursement of some US$5 billion in official financing. Trade restrictions imposed against Ukrainian goods and services combined with low prices of some of our key commodities adversely affected exports early this year and despite a more recent rebound in commodity prices, the current

account deficit is projected to widen to around 1.5 percent of GDP in 2016. The resumption of private capital inflows will enable us to speed up our accumulation of reserves.

II. Policies Under the Program

4. Against this backdrop, we have adapted program policies as needed to support economic stability and restore growth.

A. Monetary and Exchange Rate Policy

5. We remain committed to securing monetary and financial stability by maintaining a flexible exchange rate, lowering inflation, and building reserves. A flexible exchange rate will continue to support the needed economic adjustment, while higher reserves will further enhance confidence and strengthen the basis for normalizing financial conditions. To this end, the NBU has purchased some US$3.1 billion on a net basis since end-February 2015 and arranged swaps/credit lines with the central banks of Sweden and Poland equivalent to US$1.5 billion. In a break from the past, since the spring of 2015, Naftogaz has met the bulk of its FX needs directly from the market or by borrowing from domestic banks and bilateral creditors. Further, in September 2015, we started regular FX auctions, while also gradually easing administrative restrictions in line with the agreed roadmap. Notwithstanding these efforts, the PCs for NIR at end-September and end-December 2015 were missed, as lower-than-expected commodity prices, delays in official disbursements, and domestic political factors weighed on FX supply. Sizable FX purchases could have led to overshooting of the exchange rate, with harmful effects on inflation as well as bank and corporate balance sheets; and we limited FX sales to smooth exchange rate fluctuations. However, taking advantage of improvements in commodity prices in the second quarter of 2016 and banks' comfortable foreign exchange liquidity the (adjusted) indicative target for end-June 2016 was observed. To further entrench stability, we will continue to:

a. **Build reserves in line with available net inflows**. The NBU will continue to hold daily FX purchase auctions—market conditions permitting—aiming to build reserves without triggering market instability.

b. **Ease administrative FX control measures as conditions warrant**. We will ease the restrictive measures gradually and cautiously, in line with the prerequisites in the roadmap for easing administrative restrictions, while closing newly found loopholes to limit the FX drain, ensuring orderly conditions in the FX market, and supporting our efforts to build reserves. The NBU, in consultation with the IMF, will further elaborate this road map, aiming to: (i) strike a balance between preserving hard-won financial stability and alleviating the adverse effects of administrative measures on the economy and especially on our ability to attract investments, and (ii) communicate to the market progress with the implementation of the conditions-based plan to anchor expectations.

6. **Our monetary policy framework is evolving toward inflation targeting, with the primary goal to reduce inflation to single-digit levels in the medium term**. Central bank independence was enshrined last year with the amendments to the Law "On the National Bank of Ukraine." Since then, the NBU has made significant progress in implementing a forward-looking and transparent monetary policy based on macroeconomic forecasts and enhanced policy analysis, with regular and pre-scheduled meetings of the NBU Board on monetary issues. The NBU also improved its communications and operational framework to increase the transparency and accountability of monetary policy. In particular, the NBU enhanced and streamlined the interest rate framework, which now emphasizes the role of the key policy rate (currently the interest rate on 14-day certificates of deposits (CDs)) and sets a symmetric corridor around this rate, bound by the overnight standing facilities. This should strengthen the interest rate transmission mechanism and enhance transparency. The NBU will continue its efforts toward implementing inflation targeting in line with its monetary policy strategy and inflation-targeting transition road map approved by the NBU Board. To reflect this evolution of the monetary policy regime and our commitment to achieve price stability, an indicative target on headline inflation has been added. The NBU will continue to enhance its operational framework to actively manage liquidity and consult with IMF staff on the implementation of inflation targeting.

7. **The NBU's monetary policy stance will remain appropriately tight to support the disinflation process and achieve the announced multi-year inflation targets of 12 percent (+/- 3 pp) by end-2016 and declining to 5 percent (+/- 1 pp) by end-2019**. The NDA targets for end-September and end-December 2015 as well as the indicative targets for first half of 2016 were met comfortably, with base money declining more than expected and the NBU absorbing excess liquidity, mainly through 14-day CDs. To reduce the wide corridor between the NBU's deposit and lending interest rates, in August–September 2015 the NBU reduced its discount rate by 800 bps (to 22 percent) and the rarely used overnight refinancing rate by 900 bps (to 24 percent), while keeping the rate on 14-day CDs unchanged at 20 percent. In April 2016, with inflation decelerating quickly, rates were again reduced—the discount rate by 300 bps and the 14-day CD rate by 100 bps (both set at 19 percent), and narrowing the corridor for the overnight facilities to +/- 200 bps around the 14-day CD rate. In May, June and July 2016, the discount rate was further reduced to 18, 16.5 and 15.5 percent, respectively. If disinflation and reserve accumulation are on track and monetary and

financial stability are entrenched, we will continue to gradually reduce the policy rate, while maintaining rates positive in real terms on a forward-looking basis as needed to anchor inflation expectations. Conversely, if inflation or financial stability risks intensify, we will tighten monetary policy as needed.

B. Safeguards Assessment

8. In line with the recommendations of the IMF safeguards assessment of the NBU, we are taking the necessary measures to improve NBU governance and autonomy, as well as NBU internal controls. We have adopted legislative amendments to the NBU Law to address the governance and autonomy issues and remain committed to their implementation. This will include prompt re-establishment of an Audit Committee and audit charter following constitution of a new Council of the NBU, which has been held up at the appointment stage. Further, the NBU has adopted a new code of ethics, which was prepared in consultation with IMF staff. With regards to internal controls, the NBU established a permanent senior-level credit committee in June 2015 to oversee NBU's lending to financial institutions. Further, a new lending and credit risk management process has been implemented, with operations shifted from banking supervision to the newly created credit and risk management departments. Quarterly data audits are ongoing with the results timely conveyed to the IMF.

C. Financial Sector Policies

9. We have continued to make steady progress in implementing our banking sector strategy to rehabilitate the financial sector and restore confidence. Final results of the second wave of bank diagnostics and NBU's verification of related-party loans (including amounts exceeding exposure limits, according to the new regulatory framework) for the 20 largest banks have been communicated to each individual institution. As of late-July 2016, 79 banks, accounting for about 30 percent of the system assets, have been resolved as part of our continuous commitment to strengthen and consolidate the financial system.

10. Our efforts continue to go in six directions:

- making further progress with our bank recapitalization and restructuring strategy;
- unwinding excess related loans and enhancing post monitoring of financial institutions;
- enhancing banking supervision and regulations;

- strengthening governance and financial performance in the DGF and state-owned banks;
- improving the existing framework for resolving non-performing loans; and
- reforming securities markets.

Making further progress on bank recapitalization and unwinding related-party exposures

11. The NBU has completed its review of the recapitalization plans submitted by the 16 out of the 20 largest banks that require additional capital—and, where applicable, of their unwinding plans as well—and is currently monitoring the implementation of the 14 plans approved. Specifically, while bank insolvency or undercapitalization is to be addressed preferably through cash injection and/or debt conversion into equity, banks are allowed to consider, as mitigating factors, the post-diagnostic problem-loan collection, incorporation in their balance sheets of other commercial assets as means of loan recovery, addition of new valuable collateral to enhance loan quality, and consolidation of their cash-flows with those of credit-worthy affiliated companies, subject to strict conditions discussed in paragraph 11.b (below). We have resolved two banks that missed presenting a credible plan and all other 14 undercapitalized or insolvent banks have now achieved a minimum CAR of 0 percent under the June 2016 regulatory framework. Furthermore, we are also ensuring that:

a. The implementation of banks' recapitalization plans is on track, and credible actions are underway for the 20 largest banks to meet a minimum CAR of 5 percent by end-September 2016. In particular, we will ensure that any capital needs arising from the correction of old practices to calculate loan provision are addressed as part of the capital injection to meet the minimum CAR of 5 percent and in line with the new regulation on credit risk assessment. Of these banks, those that have been unable to meet a minimum CAR of 5 percent by end-September 2016 will be resolved.

b. Where applicable, if a bank's recapitalization plan includes measures to mitigate capital needs, we will ensure that the implementation of these measures meets the following criteria: (i) ***Integrity***: all rights on assets, including associated income, are transferred, and post-diagnostic loan repayments are well sustained; (ii) ***Sound legal documentation***: the transfer of ownership of assets, liens on new loan collateral, and/or cash flow association between affiliated companies is based on legally binding documentation and adequately registered in public records; (iii) ***Viability test***: the incorporation of commercial assets and the consolidation of cash flows of affiliated companies is supported by credible and sustainable financial plans; (iv) ***Proper valuation***: the value of assets received as loan repayments or new loan collateral reflects true market prices; and (v) ***Timely unwinding of non-core assets***: in case the adoption of mitigating measures were to lead to breaches of prudential limits their unwinding should be completed no later than end-December 2018. On the basis of terms of reference agreed with IMF staff, for any of the largest 20 banks that is taking mitigating measures the NBU has completed the verification of the integrity and soundness of the legal documentation associated with assets that have been transferred to the balance sheet of banks and, where applicable, the NBU has ensured that their ownership is properly registered in public records. No later than end-September 2016, the NBU will complete the verification of the mitigating measures as regards the viability test and the valuation of the transferred assets (with the valuation conducted by internationally recognized appraisers).

c. Banks showing breakeven or negative operating income through 2017, after stress tests, must submit restructuring plans by end-September 2016 with measures to be adopted in the next 12–18 months to reverse such trends and ensure its viability, defined in line with international best practices.

d. Related-party exposures that exceed limits according to the new framework are being addressed by banks in line with the well-defined quarterly targets embedded in the unwinding plans. Additionally, our work on related-party exposures also entails that:

- By end-December 2016, we will complete the review of related parties for the remaining 100 banks. The review of the first 10 largest banks in this group was completed in July 2016.
- Plans to unwind exposure to related parties may be factored in the recapitalization plans if banks provide firm assurances that a source of repayment of related loans is being set aside (e.g., by pledging marketable assets that can be quickly cashed if related loans are not repaid within the timeframe agreed in the plans).
- Upon successful completion of the first year of their unwinding plans (that entails a reduction of no less than 20 percent of the original stock of related loans) the banks could apply to the NBU to receive up to two additional years extension for the repayment of at least one-quarter of the remaining related party loans in each of the following four years, provided these loans are and remain fully performing (as defined by NBU regulations).

e. The board approved the results of the next 19 banks in July 2016. These banks are required to meet zero tier 1 capital by end-November 2016 and 5 percent CAR by end-February 2017. Any bank deemed not viable or unable to meet these deadlines will be resolved promptly. In addition, the steering committee, established at the NBU to revise the consistency of the bank diagnostics, will submit by end-November 2016 for board approval the results for the next 21 largest banks. We will ensure that these banks inject capital according to the table below. The remaining 57 banks, accounting for 2 percent of the system assets, will be subjected to a well-targeted viability and capital needs assessment by the NBU with the aim to ensure that only sound and well-run banks remain operating in the Ukrainian banking system. This targeted exercise will be run on a continuous basis and completed no later than end-June 2017.

Calendar of next 100 banks	Completion of		Recapitalization to	
	Diagnostics	Board Approval	Zero Tier 1	CAR of 5 percent
Largest 19	End-May 2016	End-July 2016	End-November 2016	End-February 2017
Next 21	End-September 2016	End-November 2016	End-February 2017	End-May 2017
Remaining banks	Continuous process to be completed by no later than end-June 2017			

Enhancing further monitoring of related-party exposures

12. We are working towards enhancing further our monitoring of the banks' related-party exposures. To this end:

a. The Related Parties Monitoring Office (RPMO) has been fully staffed to monitor monthly the level of outstanding loan amounts of all related parties included in the above-mentioned paragraph and identify a preliminary list of new borrowers in the banks subject to unwinding plans. These findings will be reported to the NBU board monthly. The first report was issued in June 2016. By end-October 2016 the RPMO, with technical assistance from the IMF, will review and, if needed revise its internal objectives and modes of coordination with other relevant NBU departments, and define a work plan for the next 12 months.

b. On the basis of our main findings during the recent review of related parties, we refined in July 2016 the relevant regulatory framework to eliminate remaining gaps that may eventually be used by banks to evade credit limits.

c. The NBU has started working on expanding the operations of its current Registry of Borrowers toward establishing by end-June 2017 a credit registry at the NBU to enhance credit risk and related-party loans monitoring. To this end, in August 2016, the NBU board approved an action plan including key steps and critical dates. By end-September 2016, the NBU will also submit the necessary amendments to the legislation to parliament to authorize the NBU to disclose information from the credit registry to banks. Furthermore, considering that more than 70 banks are under liquidation, the law will introduce requirements on these institutions to regularly report to the NBU their credit data and allowing the NBU to share such information with private credit risk bureaus.

13. We have completed our strategy and contingency planning for systemic banks in line with best international practice and principles agreed with IMF and WB staff. In case of need, we, in close consultation with IMF staff, will:

a. Assess all resolution options and on that basis the NBU board will timely submit to the Cabinet of Ministers a detailed report, including a resolution proposal and rationale, capital needs over a 3-year horizon, and a technical discussion on minimum assumptions under which the selected resolution option meets viability. The selected option will aim to avoid ultimate losses to the State and, therefore, will: fully write down existing shareholders; ensure the full and timely servicing of loans including by adequate collateralization where this is lacking and by not imposing any impediments on our ability to collect related-party or any other loans in a timely manner; and secure bail-in from all liabilities to related parties.

b. In case of bank nationalization, hire a highly recognized international firm to run the resolved bank with commercial business perspectives. Furthermore, no later than 90 days since the banks' intervention, the MoF will establish and publish a "Memorandum of Understanding" with the resolved bank in the terms described in paragraph 17 of this MEFP.

c. Follow international best practices and pursue all suitable legal and commercial means to ensure that the State secures from former bank owners the recovery, in a timely manner, of all the loans they directly, and indirectly through their holdings in other entities, owe to the bank. We will create inside the bank a special unit to manage and collect these loans, managed by an internationally recognized asset management firm (AMF) that will be appointed by the new supervisory board within the first 60 days after the bank's resolution started. Furthermore, we will ensure, through the MoF's financial policy department (FPD) that no later than 45 days after its appointment, the AMF will complete its strategy to collect the loans, including an action plan with detailed collection targets for the following 12 months.

d. Ensure that the recipient bank accounts government bonds received to cover existing gaps between assets and liabilities and as means of capitalization on the basis of international financial reporting standards (IFRS). The NBU will also follow the same accounting rules if it were to purchase such bonds to support bank resolution or receive as means of payment of our stabilization loans from the MoF.

14. We are enhancing further our legal framework to facilitate program implementation. In December 2015, amendments to the Law of Ukraine "On Measures Aimed At Facilitating Banks' Recapitalization and Restructuring" were approved by parliament.

Enhancing banking supervision and regulation

15. We are taking decisive steps to improve our supervision of banks. In mid-November 2015, we announced a number of measures to strengthen the banking system:

a. Starting January 2016, we are conducting risk-based supervision with the aim to obtain a better understanding of banks and be able to take early corrective measures when needed;

b. By end-March 2016, all banks were required to have a transparent ownership structure in place and by end-June 2016 to hold a minimum authorized capital of UAH 120 million;

c. In June 2016, in consultation with IMF staff, the NBU board approved a new regulation on credit risk activities to broadly align them with Basel principles and international best practices, including forcing banks to primarily classify borrowers on the basis of their forward-looking financial position, while relegating collateral to be a loss-mitigating factor, and ensuring that tangible loan collateral meets minimum safe and sound conditions. This regulation will become effective on September 1, 2016, and by end-September 2016 banks will submit to NBU their pro-forma balance sheet showing the impact of the new rule, but they will have time until January 1, 2017 for the full implementation;

d. Since December 2015, the NBU board receives monthly reports on potential problem banks, prepared on the basis of our revised Early Warning System. This enhanced report will help us to timely identify banks that require intensified supervisory monitoring and minimize the possibility of their further deterioration.

Strengthening bank governance and DGF's financial performance

16. We recognize that ensuring effective corporate governance is critical to the proper functioning of the banking sector. With the assistance of an external expert, by end-September 2016, the NBU will complete an assessment of its current regulatory and supervisory framework on sound risk governance practices against the 2015 Basel's Guidelines for Corporate Governance for Banks. The assessment aims to identify areas for further improvement on board qualifications and responsibilities, the banks' board structure and practices, risk management, and governance of group structures. On the basis of this assessment:

a. By end-October 2016, the NBU will submit draft legislation to parliament to address legal loopholes, and pass revised or new resolutions reflecting the findings of the assessment with the view that these will be fully implemented no later than end-March 2017; and

b. By end-June 2017, with external technical support, the NBU will complete its assessment of the collective suitability of the board and qualifications of senior management of the 10 largest banks and, where applicable, instruct banks to adopt corrective measures within 90 days. By end-August 2017, a similar assessment for the next 10 largest banks will be completed. The remaining banks will be subject to the same review through end-March 2018 in line with a calendar to be agreed with IMF staff.

17. The Ministry of Finance—as the controlling shareholder of the public banks—is committed to take the necessary steps to ensure that these banks are run on a commercial basis. In consultation with the IMF, WB, IFC, and EBRD, we have developed the Principles of State Banking Sector Strategic Reforms to govern the state-owned banks (SOBs) and provide a framework for improving their financial condition and transparency, and for their privatization. These principles were approved by the Cabinet of Ministers in early February 2016 and key policies include:

a. The SOBs' supervisory boards will be composed of 7 members, with 5 of them being independent and appointed by the selection committee (see below), while the remaining members will be appointed by the President and the Cabinet of Ministers. We have selected—with international donors' assistance—a reputable international recruitment firm to entirely run the selection process of the independent members of the SOB's supervisory boards. Bearing in mind the new NBU corporate governance requirements discussed above, this firm will present no later than end-December 2016 a short-list of candidates for the independent members of SOB's supervisory boards, from which by end-January 2017 a committee comprising representatives of the President, the Cabinet of Ministers, and IFI representatives as observers will make the selections for each of the supervisory boards. The supervisory board members will elect one of the independent members as the chairman of the respective supervisory board.

b. To enable and support the above-discussed policies, by end-October 2016 we expect parliament to adopt legislation that would facilitate the adoption of the new corporate governance approach for SOBs that *inter alia* defines the size and composition of the SOB's supervisory boards, seeks to transfer the accountability of the SOB's performance from the Cabinet of Ministers to the banks' supervisory and management boards and establish as a criminal offense efforts to unduly influence their decisions. This will help to ensure that these banks are run on commercial basis. To this end, we have hired a reputable law firm to update the draft legislation on the corporate governance of SOBs to take into account the recent changes in the legislative framework for the corporate governance of SOEs, and we aim to submit the draft legislation to parliament by end-September 2016.

c. In the first half of 2016, the three largest SOBs completed their business strategy action plans taking into account the state's timetable to gradually reduce its presence in the financial sector. These strategies may be refined later to include the views and experience of the SOB's new supervisory board members. In addition, by mid-2018 upon the effective implementation of their action plans and revised strategies, we will seek to sell, to reputable international financial institutions, no less than 20 percent of our interest in the two largest SOBs, and within the same timeframe we will aim to unwind the current full guarantee on Oschadbank's deposits. We aim to divest our interest in the other three SOBs by end-2017.

d. With IMF technical assistance, we have completed the assessment of the FPD with a view to identify actions to be implemented by end-September 2016 for the FPD to be able to effectively support the MoF's function of managing the State's interest in the SOBs.

e. By end-October 2016, in consultation with Fund staff, we will establish memorandums of understanding defining a relationship framework between the MoF and each of the SOBs in order to: (i) provide clarity about the interaction between each bank and the MoF; (ii) safeguard the banks' commercial independence in achieving their objectives, while imposing accountability for their actions; (iii) provide the MoF an appropriate level of visibility and input into certain material aspects of the banks' activities proportionate with its shareholding and deemed necessary to accomplish its mandate; and (iv) identify specific matters reserved for consultation with and approval by the MoF.

18. The DGF is working towards enhancing the quality and transparency of its asset management and recovery procedures and asset disposal planning. A centralized unit at the DGF has been established to consolidate the management and control of bank assets from the nearly 80 resolved institutions, and is now fully staffed and operating on the basis of its recently approved terms of reference and organization. DGF has also published a calendar for disposing of assets, with quarterly targets through 2016, and is working in the following four fronts:

a. ***Accountability***. A progress report on asset disposal and recovery is set to be published no later than 30 days after the end of each quarter. The first report is due in July 2016;

b. ***Efficiency***. New strategies to place bank assets in the market are being developed, which entail: (i) providing access to electronic data rooms to potential buyers; and (ii) using more expeditious mechanisms widely used in other jurisdictions to sell assets in a transparent manner. To support these efforts the Ministry of Justice has passed a resolution to facilitate DGF work in these areas. Moreover, by end-September 2016 we will submit legislation that will further enhance the DGF's ability to work with assets in a timely and efficient manner and increase the amount of net cash recoveries on assets, as well as providing legal protection to DGF staff. By end-November 2016 we will place the first batch of assets under these new asset-sale modalities;

c. ***Transparency***. Selectively, but ensuring that all transactions above certain threshold are approved by the DGF board are included, the DGF's anticorruption office will each quarter deliver an ex-post evaluation of the process followed to dispose assets in the preceding quarter with the aim to verify that DGF integrity policies have been met. Upon its discussion at the DGF board, we will publish the first results of these evaluations no later than end-September 2016;

d. ***Forensic review***. The investigation by two specialized firms of the main factors that drove two medium-sized domestic banks into liquidation continues. We aim to publish an executive summary of these reports no later than end-September 2016.

Improving the existing framework for resolving non-performing loans

19. We have made progress in strengthening our framework for NPL resolution. Parliament adopted in June 2016 the Law of Ukraine "On Financial Restructuring," designed with technical assistance from the EBRD and the World Bank, which prescribes a coordinated out-of-court restructuring procedure for non-financial corporates in line with international best practice. Amendments were also made to the Tax Code earlier this year to remove impediments to out-of-court debt restructuring.

20. However, further work is required to strengthen the corporate insolvency regime. In this regard, we have established a committee chaired by the Ministry of Justice and including the Ministry of Finance and other relevant agencies. The committee is currently in the process of drafting amendments to the Law "On Restoration of Debtor's Solvency or Declaration of its Bankruptcy," to advance the reforms identified by the March 2015 IMF technical assistance mission. We will incorporate these amendments to draft bill No. 3132, currently in parliamentary procedure. Thereafter, we expect the revised bill to be adopted by parliament by end-September 2016 (a new completion date for the **structural benchmark**, which has been reformulated to focus on insolvency law reform). Meanwhile, we are continuing to work with IMF staff to amend legislation to: (i) remove tax impediments to insolvency and (ii) strengthen the legal regime for credit enforcement (e.g., amending the mortgage law, the commercial code, and civil procedure codes), consistent with IMF staff advice. We expect adoption of this legislation by end-December 2016.

21. We will support the approval of legislation that would guide the restructuring of foreign currency denominated mortgage loans serviced by distressed but still performing

borrowers without interfering in bilateral negotiations between borrowers and banks. We will ensure this legislation will: (i) aim to protect the rights and interests of individuals that can demonstrate to be in financial difficulties; (ii) target borrowers with loans that do not exceed UAH 2.5 million as of end-December 2013 (about US$150,000) and who live in the mortgaged properties as their primary residence; (iii) establish a voluntary process where eligible borrowers would apply to banks for restructuring and can prove their difficult financial situation; (iv) guide banks to restructure loans on the basis of the borrowers' financial condition and capacity to pay and with banks—after considering reasonable living expenses—making a proposal to borrowers that may include debt conversion and interest and principal reduction; (v) require banks to establish an independent and credible mechanism to deal with customers' complaints; and (vi) will not impose a cost on the banking system that is estimated to exceed US$370 million (0.4 percent of GDP). We expect legislation consistent with these principles to be adopted by end-September 2016. We will ensure that no law will be adopted that does not meet the conditions listed above. Simultaneously, we will also lift the moratorium on collateral foreclosure.

Reforming the securities markets and other non-banks

22. We are addressing significant challenges faced by the National Securities and Stock Market Commission (NSSMC) in its role as the regulator of the Ukrainian securities market. These challenges include the issuance and trading of fictitious securities in the market and insufficient powers to conduct effective supervision. They also severely constrain the ability of the NSSMC to cooperate with foreign supervisors and, as a result, to receive reciprocal assistance from them. To this end—and to bring our legislation in line with IOSCO Principles and with a view for Ukraine to become a signatory of IOSCO's Multilateral Memorandum of Understanding—Parliament will adopt legislation by end-September 2016 to allow the NSSMC to:

a. Conduct inspections of regulated entities without the existing undue constraints, including by removing any remaining moratorium on the NSSMC's ability to conduct certain inspections;

b. Conduct audits of any legal or natural person to determine compliance with securities laws;

c. Demand and have access to information from any natural or legal person to determine compliance with securities laws, including by introducing appropriate exemptions from the existing secrecy laws (such as banking secrecy and protection of personal data);

d. Have the ability to share with foreign authorities information in the possession of the NSSMC or acquire such information on the foreign authorities' behalf to determine compliance with securities laws;

e. Use any of its available powers to provide assistance to foreign authorities regardless of whether the NSSMC has an independent interest in the matter;

f. Adopt regulations under Ukrainian securities laws without any external approval/agreement/registration;

g. Have access to a larger and more stable source of funding than currently; and

h. Provide appropriate legal protections to the NSSMC and its Chairman, Commissioners and staff.

To ensure that NSSMC's new powers are appropriately exercised, the above legislations should:

i. Require the NSSMC to establish proper confidentiality and data protection framework in order to safeguard information from improper disclosure;

j. Subject the NSSMC and its Chairman, Commissioners and staff to confidentiality requirements and effective administrative and criminal sanctions for undue disclosure of confidential information, even after they have separated from the NSSMC.

In addition, we are taking decisive steps to enhance further the functioning of financial markets:

k. We have submitted for parliamentary approval key draft legislation to transfer regulatory and supervisory responsibilities of a variety of financial intermediaries from the National Commission of Financial Services (NCFS) to NBU (insurance and leasing companies, credit unions, credit bureaus and other non-bank lenders, pawnshops and other financial companies) and NSSMC (private pension funds, issuers of mortgage certificates and funds for construction financing and real estate funds) with the aim to consolidate the oversight of our financial markets. We are working to ensure this legislation is fully implemented by end-December 2016.

D. Fiscal Policy

23. **We are determined to continue our fiscal consolidation to strengthen public finances which is critical to support financial stability in Ukraine**. To complement our fiscal efforts and bring debt firmly on a sustainable path, we have concluded a debt operation with private creditors and are advancing discussions with other creditors, consistent with the objectives of our program, aiming to achieve debt sustainability, which we aim to complete soon.

24. **We have met the fiscal targets for 2015**. The general government budget performed strongly in 2015, on the back of robust revenue growth, firm control overspending, and savings on

interest payments resulting from debt restructuring. This performance allowed us to bring forward the planned indexation of pensions and wages from December to September 2015 which helped mitigate the negative effects from high inflation on the most vulnerable groups of the population, at an additional cost of about UAH 9.9 billion. In addition, we re-allocated some funding (UAH 5.6 billion) from various line ministries to defense spending and increased the allocation for clearing VAT refunds, which had increased since the beginning of the year.

25. For 2016, parliament adopted a budget consistent with a general government deficit target of 3¾ percent of GDP, which is critical to continue a gradual fiscal adjustment and entrench stability (a **prior action** for this review). To achieve this target, a significant rebalancing of the budget was required given the need to: (i) offset the loss of one-off revenues that were available in 2015; (ii) provide an additional allocation for energy-related social assistance to mitigate an adverse impact on households from the gas price increases; and (iii) offset the revenue loss from a reduction in the social security contribution (SSC) rate. To support our efforts to contain current spending, we have introduced a ceiling on state budget (general fund) current primary expenditure (a new **indicative target**). The indicative targets on the cash deficit of the general government for the first half of 2016 were met with comfortable margins.

26. To support the 2016 budget, parliament also adopted a number of tax policy changes (also a **prior action** for completing this review) aiming to: (i) significantly reduce labor taxation, which was high by international standards, and has led to considerable shadow employment and underreporting of wages; (ii) broaden the tax base and reduce opportunities for tax evasion and corruption; and (iii) raise some taxes to meet program targets. Key elements of these changes, which are effective since January 1st, 2016, include:

a. *Social Security Contributions*. Different social security contribution rates were unified into a single rate of 22 percent payable only by the employer and the cap on the base for social security contributions was raised to 25 minimum wages from 17 minimum wages.

b. *VAT*. The special VAT regime in agriculture, which exempts agricultural producers from paying VAT to the budget was terminated effective January 1, 2017. As a transitional measure for 2016 only, grain producers are required to remit 85 percent of their net VAT obligation to the budget, livestock breeders and milk producers 20 percent; and all other agricultural producers 50 percent. We are committed not to extend the transitional arrangement and will not amend bullet 4 of article 2 of chapter XIX of the tax code, which requires expiration of the special VAT regime on January 1, 2017. From this date onwards, the general VAT regime will apply equally to all agricultural producers. We have also subjected gas transit to VAT, replacing the current royalty regime.

c. *VAT refunds*. To address the problem of recurring VAT refund arrears on a sustainable basis, we no longer include projected amount of VAT refunds in annual budget law annexes and the Ministry of Finance does not include the amount of VAT refunds in the monthly revenue plan (ROSPIS) for the state budget.

d. *Excises*. In view of the depreciation of the hryvnia and high inflation, we raised specific excise tax rates on ethyl spirits (by 50 percent), fortified and sparkling wines and beer (by 100 percent), tobacco (by 40 percent), as well as on gasoline and diesel (by 13 percent).

e. *Corporate income tax*. We kept the rate unchanged at 18 percent. To avail the budget additional revenue from lower social security contributions already in 2016, we introduced quarterly accruals and payments of corporate income tax.

f. *Personal income tax*. We introduced a single rate of 18 percent to replace the current two rates of 15 and 20 percent, and will continue to apply a tax deduction of half of a minimum wage only for individuals with incomes below 1.4-times the minimum subsistence for able-bodied individuals.

g. *Simplified tax regime*. We increased the rates for the taxpayers falling in groups III and IV of the simplified regime, and reduced the qualification threshold for the third group to UAH 5 million from UAH 20 million.

h. *Property taxation*. We raised the rate and expanded the property tax base to include luxury houses and apartments, and expanded the tax base for the recently introduced luxury vehicle tax.

i. *Taxation on gas extraction*. We lowered royalty rates on gas extracted for commercial purposes to 29 percent (on wells shallower than 5 thousand meters) and 14 percent (on wells deeper than 5 thousand meters) from 55 percent and 28 percent, respectively. We are considering the possibility of further amending the petroleum taxation by end-September 2016 with a view of establishing a flat royalty rate independent of the well depth and introducing a corporate profit tax surcharge. We also lowered royalty rates on gas for companies that are required by law to supply gas for households and heating companies to 50 percent from the current 70 percent from April 1, 2016. To compensate for the potential revenue loss from these companies, we have increased the sales price for companies whose gas supplies form the stock of gas for households and heating companies to UAH 4849 (about US$185), excluding VAT, effective May 1, 2016.

j. *Other revenue measures*. We increased royalties on the mining of amber and increased dividends from state-owned enterprises by raising the government's statutory share to 75 percent. We will also adopt all necessary legislation to legalize amber mining by end-October 2016 and eliminate the distortive foreign exchange transaction tax for cash operations by end-October 2016. We have also launched renegotiations of double taxation avoidance agreements with key partners with a view of minimizing tax avoidance.

27. We are complementing our tax policy reform with strong revenue administration improvement efforts. The implementation of the recently approved revenue administration reform plan, which is an important priority for 2016, will help build an efficient public revenue collection system that ensures fair and transparent application of tax laws, reduces complexity and arbitrariness, and promotes tax compliance and the development of the private sector. We recognize the damaging effect of tax amnesties on tax compliance and, therefore, in case any tax reform during the program period includes elements of a tax amnesty, any such elements will be agreed with IMF staff, with a view to avoid an adverse impact on tax compliance and on our efforts to tackle corruption. Thus, we will not consider any such amnesty until significant progress has been made in reforming the State Fiscal Service (SFS), including as outlined below, so that it can effectively detect undeclared incomes and enforce taxation. Further, any consideration of forgiveness of tax liabilities would only apply to undeclared or underreported but lawfully obtained incomes or assets. More specifically, our further efforts in 2016 to strengthen revenue administration are focused on the following areas:

a. Continued progress in implementing the revenue administration reform plan. We moved all large taxpayers to the Large Taxpayers' Office as of end-December 2015 (**structural benchmark**). The SFS started to implement its new organizational arrangements as specified under the revenue administration reform plan from end-December 2015 (structural benchmark). We have largely finalized downsizing the SFS reducing the staff from about 58,800 to about 44,000 as of end-April, 2016. By end-September 2016 Parliament will adopt a law to introduce a one-level internal dispute resolution at the SFS. Our objective is to merge the tax and customs administration into a single legal entity, to take advantage of synergies, and we expect parliament to adopt a law to this effect by end-December 2016 (a new **structural benchmark**). As an interim step, by end-September 2016 the Cabinet of Ministers will adopt a resolution to merge the tax offices into a single legal entity and the parliament will adopt legislation to merge the customs offices into a single legal entity within the structure of the SFS, while also providing signature rights to heads of regional branches. We will ensure that the structures of the reformed tax and customs administrations are fully compatible with one another to allow for their merger and the reorganization of the SFS along functional lines by end-December 2016. As part of these efforts, by end-December 2016 we will also consolidate regional offices and substantially reduce administrative functions at regional and local levels, and move all audit and debt management functions to the regional/headquarters level to ensure tighter supervision and greater expertise leaving only front-office functions at the local level. We will furthermore dissolve the tax police and, in consultation with IMF staff, establish by end-October 2016 a new civil service with new staff under the Ministry of Finance that will be responsible for investigation of financial and economic criminal offenses against the State, including tax-related offenses, while removing the role of other government agencies in this area, but without infringing upon the investigative jurisdiction of NABU. Following the completion of the SFS reform, we will consider bringing the new tax investigations service within the SFS structure.

b. In addition, we are finalizing draft legislation that will establish criteria for the identification of High Net Worth Individuals (HNWIs), bring them under a new audit program, and provide the SFS with adequate tools to reveal noncompliant taxpayers, including the possibility to access bank account information but with strong safeguards in place to minimize the risks of abuse by SFS staff. We will also allow the moratorium on tax audits for taxpayers with an annual turnover of less than UAH 20 million to expire at end-2016 as envisaged under the Tax Code. We will finalize draft legislation to strengthen the administrative enforcement of debt collection in line with best international practices, and authorize the SFS to use indirect measurement methods to ascertain the correct tax and social security obligations of any taxpayer. We expect to have this legislation adopted by end-October 2016, when we expect to have made significant progress in the reform of the SFS.

c. We recognize the importance of providing adequate compensation for SFS staff as part of our integrity strategy. Therefore, concurrently with the completion of the vetting and re-appointment of staff, we will implement targeted compensation reform at the SFS, which will aim at bringing salary levels at SFS comparable with those in other reformed government agencies (e.g., patrol police) and ensure adequate funding for key IT systems and customs during 2016 but within the limits of SFS's current budgetary allocation. We will also give priority to raising professional standards in SFS.

d. To strengthen compliance for social security contributions, effective January 1, 2017 we will harmonize the bases for social security contributions and the personal income tax and offer the possibility of single filing and payment. To help achieve these objectives we will finalize the relevant plan and launch a taxpayer awareness program by end-September 2016.

e. We have established a new internal investigation division at SFS with new staff, who in cooperation with other government authorities will assess risks, analyze annual reports on assets of high-ranking SFS officials, and carry out investigations as part of our efforts to tackle corruption. The activities of the investigation division will be under control of a recently established independent expert group, who will ensure publication of their monitoring work on an annual basis. We will arrange for regular independent surveys to monitor the evolution of public perception.

f. In addition to its fiscal role, the ongoing reform at customs will provide greater facilitation of trade and improve the security and safety of the society through more effective border controls. As envisaged in the revenue administration reform plan, we will aim to appoint a new deputy head of SFS in charge of customs by end-September 2016. We will adopt amendments to the customs code by end-September 2016 that allow for the harmonization of requirements for the authorized economic operator with EU legislation. We will equip the SFS with appropriate powers and establish a post-clearance audit program by end-September 2016. To simplify, further automate, and streamline customs clearance processes through the implementation of a one-stop-shop service on customs, the cabinet adopted in May 2016 the relevant resolution, for which implementation started in August 2016. In that context we will minimize the instances of physical inspection of cargo, develop and publicize the customs-specific integrity action plan, and strengthen coordination with the state border guard services to limit the illicit inflow of goods and exchange of information with customs administrations of major trading partners. We have identified a set of key ICT projects with the highest priority for customs and are seeking external funding. We will also improve customs valuation procedures by applying European best practices and promote a conditional release procedure as a way to avoid undue delay in the processing of declarations from the third quarter of 2016. We will prepare a project plan for the further development of risk management to address current weaknesses, future plans and requirements and organizational and management issues by end-October 2016. In order to minimize probable revenue leakages resulting from weaknesses at the border, in transit and inland clearance facilities, we will initiate a third-party inspection of these weaknesses with the aim of completing at least three largest border-crossing points and inland clearance facilities by end-December 2016.

g. We will establish key performance indicators (KPIs) for the SFS in consultation with IMF staff for 2016 and 2017 in September 2016. These targets will focus, *inter alia* on core performance outcomes of tax and customs administration including audits, the collection of tax debts, eliminating the stock of VAT refund arrears and the internal reorganization. In 2016, we will also continue reducing the stock of corporate income tax prepayments, which have accumulated over the last few years, within the space created by any revenue over-performance.

h. Following the shift to a new VAT refund system in 2016, we will delink the payments of VAT refunds and the consideration of meeting net VAT revenue targets established by monthly plans, which should allow us to entirely clear the outstanding stock of VAT refund arrears.

28. We recognize the need for a fundamental reform of the simplified tax regime, which remains overly complex and offers opportunities for arbitrage. Therefore, by end-September 2016 we will develop a proposal and take action to address its abuse and lessen the concessionality and complexity of the current regime and narrow the gap in the tax burden with those under the general tax regime.

29. To remain consistent with the program deficit target, we have also developed permanent expenditure saving measures as part of a medium-term reform effort to improve the efficiency and quality of public services:

a. *Pension reform*. Demographic trends and the sharp reduction in the social security contribution rate are set to widen the pension fund's structural deficit considerably in the coming years, demanding significant transfers from the state budget. To address these challenges in a sustainable manner, we are committed to pursue a multi-phased reform strategy:

- We already implemented the first phase of reforms in 2015 by eliminating special pensions for civil servants and other privileged groups, and by increasing the retirement age and the qualified period of service for a number of professions eligible for early retirement. We also extended the pension withholding for working pensioners introduced in March 2015 through end-2016, and decoupled the size of the maximum pension from the minimum wage and kept it unchanged at UAH 10,740. To continue phasing out special privileges, we have as a **prior action** for this review adopted a Cabinet of Ministers' decree reducing the list of occupations eligible for early retirement by at least 40 percent in terms of eligible persons.

- To reduce the very high pension fund deficit that threatens the viability of the pay-as-you-go system and to improve its fairness and ability to provide adequate pensions over time, we will, by end-December 2016, adopt legislation (a new **structural benchmark**) to:
(i) gradually adjust the statutory retirement age and further reduce the scope for early

retirement; (ii) tighten the eligibility criteria for the minimum pension; (iii) consolidate pension legislation, which is now spread across about two dozen laws, and ensure a single principle for providing pensions without privileges for any occupation (with the exception of the military); (iv) expand the base for social security contributions; (v) ensure equitable tax treatment of pensions; and (vi) better link benefits to contributions, also to encourage the declaration of actual incomes. In addition, we will separate various categorical pension supplements from the labor pensions, bring their financing from the pension fund to the state budget and improve their targeting starting from 2017 to make the system more equitable and free up resources for more efficient poverty alleviation.

- Until all the above measures have been adopted and the pension system is set on a sustainable basis, we will refrain from introducing a second pillar to the pension system.

b. *Wage bill*. Budgetary sector wages will increase taking into account the minimum wage growth by 5 percent on May 1, 2016 and 10.4 percent on December 1, 2016, compensating budgetary employees for the expected inflation and to help cushion the impact of increasing gas tariffs to cost recovery earlier than targeted.

c. *Social assistance and social insurance reform*. We will improve the targeting and progressivity of a number of social assistance programs through better means-testing; streamline and consolidate programs with similar objectives; and realign the housing utility subsidies to prevailing international market prices for natural gas. In addition, the Ministry of Finance will complete the verification of beneficiaries of pensions and social benefits and take recourse against ineligible beneficiaries by end-December 2016, and reduce the administrative costs of the social insurance funds.

d. *Education reform*. We will continue our efforts to improve performance and standards in education. The reforms, which will be implemented by September 2016, will also improve spending efficiency, including by: (i) further optimizing the school network through closing smaller schools and transferring students to better equipped schools; (ii) improving targeting of financial assistance to students through better means-testing; (iii) streamlining research institutions; (iv) facilitating private funding of higher and vocational education institutions; and (v) devolving part of vocational school funding to lower levels of government.

e. *Healthcare reform*. To improve the efficiency of the health care system as well as the quality of services to the population, we will undertake reforms aiming to lead to higher decentralization, increased managerial autonomy for hospitals, and transition away from funding based on the number of hospital beds to funding services. A full reform law will be adopted by parliament by end-December 2016. As a first step to address large inefficiencies in the hospital sector we have lowered the statutory limit on the number of hospital beds per ten thousand residents to 60 from 80 with a commensurate downsizing of hospital staff by end-September 2016. In addition, we have reformed the procurement system for pharmaceuticals in line with European standards and principles. In particular, procurements are made with involvement of the specialized organizations, since the beginning of 2016.

f. *Other expenditure measures*. We will rationalize subsidies, including to state-owned enterprises (SOEs); following the adoption of the new Law on Procurement, we have started implementing e-procurement from April 1, 2016 at the central government and from August 1, 2016 have started implementing for all other public entities; increase co-payments or cut costs for cultural programs and public transport by end-September 2016; and further streamline the number of government agencies. During 2015, we have reorganized ten and liquidated eight government agencies. With the assistance from the EU, we have started developing a comprehensive public administration reform strategy and we will ensure that the strategy is fully aligned with our medium-term fiscal program. Further downsizing of the public sector could provide room for targeted wage increases to support efforts in combating corruption.

30. Moreover, we will strengthen our budgetary process to encourage more efficient use of public funds. In line with IMF technical assistance recommendations, we intend to institutionalize a spending review process. In support of the spending review process, we will impose hard budget constraints on line ministries, encouraging them to identify savings within their resources envelopes. We will use the spending review process to develop high quality expenditure saving measures. In cooperation with the EU and other international partners we will develop and Cabinet will adopt by end-December 2016 a comprehensive public financial management reform plan, which will include specific, measureable and time-bound actions in the areas of medium-term budgeting, cash and debt management, financial controls, transparency of government finances and fight against corruption.

31. Finally, the increase in gas and heating prices to full cost recovery is being accompanied by significant additional social assistance, with improved targeting, to support vulnerable households. Specifically:

a. As part of the 2016 budget, we increased the envelope for energy-related benefits (privileges and HUS) from around UAH 24.4 billion in 2015 to UAH 35 billion in 2016, and issued a supplementary budget to further increase it to UAH 40.3 billion to support the advanced increase of gas prices to cost recovery. We have initiated reforms to improve targeting to support vulnerable households and help to ensure that these programs remain fiscally affordable, including by: (i) giving energy privileges recipients the choice between the privileges and HUS programs (but not both) and; (ii) updating the consumption norms for the HUS program to bring them closer to current consumption levels. We are reviewing and will adjust the parameters of the utility-related social assistance programs, including the HUS benefits formula, to ensure that benefits remain within the allocated fiscal envelope (a new **structural benchmark**).

b. We have initiated a central monitoring system of the characteristics of households participating in the privileges and HUS programs. The system contains information on number of recipients, household income, and the amount of subsidies. By end-September 2016, we will expand the capabilities of the system to report benefits and consumption levels across the income distribution, which is critical to improve targeting. We will regularly analyze this information to monitor whether the two existing programs deliver assistance as intended. We have mailed HUS applications to every household and have taken steps to manage the surge in applications for social assistance, including by dedicating adequate budget resources and additional staffing.

E. Energy Sector Policy

32. We continue to make significant progress with improving Naftogaz's finances and advancing the agreed energy-sector reforms.

a. The Naftogaz deficit remains within program targets. In 2015, the cumulative cash deficit reached UAH 18.2 billion (0.9 percent of GDP), below the program target. We remain committed to eliminating the Naftogaz deficit by end-2017.

b. The independent diagnostic of Naftogaz receivables was completed on time by Price Waterhouse Coopers with external funding by the UK's DFID. The associated report, which contains recommendations to improve debt recovery, was shared with the IMF, and the first section of the report was published on September 30, 2015.

c. We have revised the formula for the distribution accounts collecting district heating bill payments to ensure that Naftogaz receives a share proportional to the current cost of gas in the heating tariff and reintroduced the "adjustment coefficient" that allows Naftogaz to gradually collect payments for district heating company arrears that have accumulated since September 1, 2015. We will take any necessary actions to ensure that the distribution accounts remain operational.

d. We have adopted much of the secondary legislation needed to facilitate the application of the new gas market law, which became effective on October 1, 2015. This secondary legislation allowed for below-international-parity gas pricing for a transition period until 2017 and the provision of subsidies to vulnerable consumers.

e. We have extended the allowed use of the state guarantees allocated in the 2016 budget for general purposes and for Naftogaz's borrowing to also cover at least US$700 million as well as external guarantees provided by IFIs and private parties for the benefit of Naftogaz.

f. We will ensure that the moratoria on Naftogaz collection enforcement proceedings against energy companies and SOEs that were abolished as part of the conditionality for the first program review will not be reintroduced. Thus, we have reversed parliament's decision to extend the moratorium on collection enforcement proceedings against Energoatom and the district heating companies.

33. Moreover, we have accelerated our efforts to eliminate Naftogaz' deficit and to transform the gas sector.

a. Reflecting our commitment to raising gas and heating prices to cost recovery levels based on import parity, the Cabinet of Ministers has published a decision to unify the retail gas tariffs at a level consistent with full cost recovery effective May 1, 2016 (a **prior action** for this review). A decision by the Energy and Utilities National Regulatory Commission (NEURC) was also published to increase retail heating tariffs to a level consistent with gas priced at full import parity effective July 1, 2016 (a **prior action** for this review). To ensure that tariffs remain at full cost recovery, we will revise by end-October 2016 the Public Service Obligations (CMU Resolution 758) to introduce an interim mechanism to adjust retail gas and heating tariffs on a quarterly basis if tariffs deviate from full cost-recovery levels (based on import parity as defined in the TMU) by 10 percent or more (a new **structural benchmark**). The first price adjustment, if needed, will be effective from January r 1, 2017. The interim adjustment will remain in place until tariffs are fully liberalized, which will take place no later than April 1, 2017. We will also adjust the price of domestic gas (UGV price) quarterly starting October 1, 2016 to ensure that it remains in line with import prices.

b. To facilitate the full liberalization of gas tariffs, we will further amend CMU Resolution 758 of October 1, 2015 so that tariffs on gas transportation and distribution are separated from the gas cost as commodity. We will also monetize the benefits of the HUS program by end-March 2017 so that private gas traders can compete with Naftogaz to supply gas to households and utilities, and create incentives for energy conservation.

c. To further improve Naftogaz collections from heating companies, in June 2016 the NEURC adopted a resolution to introduce compensation for technical losses into heat tariffs and set targets to reduce technical losses, and this resolution will become effective by September 1, 2016.

d. Furthermore, by end-September 2016, we will adopt the remaining amendments (Bill 4868) needed to facilitate the application of the new gas market law.

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

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

Anticorruption

35. We are determined to accelerate the implementation of our anticorruption agenda and have largely completed the enabling statutory framework for key legal and institutional reforms, which will now allow us to shift our focus toward implementation. Specifically:

a. We have ensured that the National Anti-Corruption Bureau of Ukraine (NABU) became operational (an end-January 2016 **structural benchmark**). It has started recruiting and training its staff. Out of a total envisaged complement of 700, about 453 staff, including 142 detectives, have been hired and are receiving training. More generally, the management of NABU is steadily implementing its Action Plan, which was developed with the support of various donors.

b. We also adopted legislation on the asset recovery and management office and on asset confiscation and seizure. The latter provides the NABU with the ability to carry out provisional measures, such as freezing and seizing of assets, in order to prevent any dealing, transfer, or disposal of assets, in line with FATF recommendation 4.

c. The Ministry of Finance has produced a strategy to reform the AML reporting framework. The reform should ensure that reporting entities focus their reporting efforts on suspicious transactions, as defined by the Financial Action Task Force (FATF), rather than sending millions of routine reports yearly, the large majority of which do not contain useful information, and requiring a burdensome manual processing by banks. The strategy has been issued after consultation with relevant public and private stakeholders and with support of IMF technical assistance.

d. The NBU put into force risk-based off-site and on-site AML supervisory tools, focusing on risks related to domestic politically exposed persons, incorporating technical advice received from Fund staff.

e. We have established a specialized anticorruption prosecution function in charge of overseeing NABU's investigations. The head of the anticorruption prosecutors and two deputies have been appointed following a process ensuring broad public support, as a **prior action** for this review, and adequate premises have been allocated.

f. We have also amended the Law on the Prosecutor's Office to ensure that a timely, fair, and balanced appointment process of anticorruption prosecutors is made sustainable over time, as previously agreed in the context of the first review and described below. In particular, the approved amendments provide for the following:

- The members of the Selection Committee must be persons of impeccable reputation and high professional qualities;

- The nomination of Selection Committee members by the General Prosecutor shall be an interim measure, until the Council of Prosecutors is established. At that point, Selection Committee members currently nominated by the General Prosecutor shall be nominated by the Council of Prosecutors;

- The Selection Committee will be chaired by a widely recognized and well-respected expert from among the members appointed by Parliament with a rich experience, interest, or record of advocacy in the prosecution of corruption;

- The Selection Committee will submit only one candidate for each of the three positions (head and two deputies of the anticorruption prosecution function) to the General Prosecutor, after having confirmed that a candidate satisfies the eligibility requirements prescribed in the laws of Ukraine "On power purification" and On the prevention of corruption", and the security clearance requirements prescribed in the law "On State secrets."

- The authority for the nomination and dismissal of other prosecutorial and non-prosecutorial staff of the anticorruption prosecutor's office is to be granted to the head anticorruption prosecutor.

g. Parliament also adopted legislative amendments enabling the launch of a comprehensive electronic system for asset and income disclosure by high-level officials. Among the key features of this framework are: (i) asset disclosures for the high-level officials subject to NABU's jurisdiction include information on beneficial ownership and control of any funds or other assets (as defined by the FATF); (ii) high-level officials are prohibited from receiving any gifts and advantages other than of very low value; and (iii) the NABU can use its powers to ensure the reliability of these asset and income disclosures at any point. The electronic filing system was fully launched in accordance with law 2014/49, as amended, on September 1, 2016 by the National Agency for the Prevention of Corruption (NAPC).

36. Looking ahead, we will take the following measures to further strengthen the implementation of anticorruption efforts:

a. We will submit legislation to parliament, for adoption by end-November 2016 (a **new structural benchmark**) to ensure that (i) 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; and that (ii) the registration of pre-court cases and of investigative judges' rulings pertaining to NABU should be protected from leakage of information related to ongoing investigations, by restricting access to the information to NABU and SAPO officers until the investigation of the case is completed, or the case is closed, without undue restriction to an individual's right to defense.

b. To monitor progress made in implementing the anticorruption legal framework, the NABU will publish statistics on acts of corruption related to high-level officials under the NABU's jurisdiction, on a webpage freely available to the public (in line with the template detailed in paragraph 96 of the TMU) and on a quarterly basis. We will publish the information for the first and second quarters of 2016 by mid-September 2016. Subsequently, publication of these statistics will occur by the end of the month following each quarter.

c. All high-level officials are required to file their assets and income declarations, as defined under Article 46 of law 2014/49 for the calendar year 2015 within 60 days of the launch of the e-filing system, and officials that filed during the period the system operated in test mode will have to resubmit their submission, and the disclosures will be made freely available to the public on a single website shortly after submission (a **new structural benchmark** for end-October 2016). We are committed to make any further revisions to the disclosure system as needed to ensure that it is effective, in agreement with IMF staff.

d. The NBU has completed 8 targeted inspections of banks, focused on regulatory requirements related to customer due diligence and politically exposed persons, to address the risks of misuse by corrupt officials, and it will publish on an ongoing basis the sanctions imposed for breaches of AML/CFT requirements by banks.

e. We are taking steps to implement the strategy adopted to reform the AML reporting framework to ensure that necessary legal, regulatory and institutional changes are implemented by the end of 2016. In particular, we will adopt amendments to the legal framework by end-September 2016 to ensure a three tier reporting system (i) suspicious transaction reports as defined by the FATF, (ii) threshold based reporting of cash transactions and international funds transfers, and (iii) mandatory reporting of transactions related to high-risk jurisdictions and politically exposed persons. We will strengthen the operational capacity and integrity of the Financial Intelligence Unit (FIU), including by appointing its head in line with the process set forth in the new law on government administration, and increasing staff salaries closer to those of other agencies involved in tackling corruption. To monitor its contribution to anticorruption efforts, the NABU will publish quarterly statistics on the information it receives from the FIU (in line with the template detailed in paragraph 97 of the TMU). By mid-September- 2016, the information for the first and second quarters of 2016 will be published. Subsequently, publication of these statistics will occur by the end of the month following each quarter.

f. We will adopt a law ensuring the establishment of a specialized anticorruption court, as provided in the new law on the judiciary, following a review and analysis of the efficiency of such courts functioning in other European countries, in line with European standards and best practices.

g. We will adopt, by end-November 2016, a Law on the Business Ombudsman. The law will include clauses that ensure adequate authority, immunities consistent with international practices, authority to impose administrative penalties, and access to information to facilitate the exercise of the function.

Judicial reform

37. On judicial reform, Parliament passed a constitutional amendment in June 2016, which brings important structural changes to the judicial organization and status of judges. A prior draft of these changes received a favorable opinion of the Venice Commission (October 26, 2015). The amendment, among other things, enhances judicial independence including by abolishing the probationary period for judges, introducing objective recruitment standards and procedures, and strengthening the management by judges of the judiciary. Parliament also enacted a new Law on the Judicial System and the Status of Judges, which implements the constitutional amendment. We will establish the civic integrity councils (designed to enhance the professional ethics and the integrity of judges) within three months from publication as provided by that law. Further reform measures called for by these statutes will be developed and implemented in the coming months. Progress is also made in the following areas:

a. *Orders of Payment and Garnishment*. We are making steady progress on the structural benchmark on Orders of Payment and Garnishment. In this regard, draft laws that provide inter alia for electronic submission of order for payment claims, will be enacted by end-September 2016 (modified **structural benchmark**). These laws will amend relevant parts of the Code of Civil Procedure and the Code of Commercial Procedure.

b. *Private Enforcement Profession*. In June 2016, parliament adopted a law establishing a profession of private enforcement agents, as set out in the February 2015 and July 2015 MEFPs.

c. *High Council of Justice and High Qualification Commission*. With the objective to track progress in the resolution of the backlog of disciplinary cases against judges, we will provide adequate financing to the High Council of Justice and the High Qualification Commission so as to enable them to commence routine publication of statistical data by end-November 2016. The data will include the following: the number of cases closed, entered and pending for each time period, and the sanctions applied for each case closed, if any. The first such data set will cover Q1, Q2 and Q3 of 2016, up to and including September 30, 2016. Thereafter, such data shall be published on a quarterly basis throughout the period of the arrangement.

d. *Court Fees*. The May 2015 law on the increase in court fees (end-May 2015 structural benchmark) envisaged that its implementation would begin by September 1, 2015. In this regard, the State Judicial Administration (SJA) has begun implementation of the law and is already recording a rise in revenues from court fees. The SJA will also closely monitor whether the increased fee requirements are having a limiting impact on the filing of frivolous suits, which was also an objective of the law.

Business climate and deregulation

38. We are implementing, albeit with some delays, the action plan to remove regulatory and legislative impediments to a growth-conducive business climate. In this context, we are updating the action plan to reflect achievements to date and to incorporate additional deregulation initiatives. Monthly implementation reports are being published on the State Regulatory Service's and the Cabinet of Ministers' websites, following submission to the cabinet. Looking ahead:

a. The Cabinet of Ministers will take all the necessary steps to ensure the full implementation of the plan, including the publication of monthly implementation reports. In particular, priority actions 1, 2, and 5 from the plan, aimed at streamlining clarifying business registration and operation procedures, were adopted by the Cabinet. Moreover, the Cabinet of Ministers will cooperate with Parliament to ensure adoption of the legislation necessary to implement actions 2, 5, 50, 54, and 62 from the plan by end-September 2016. The Cabinet of Ministers approved an updated methodology for regulatory impact assessment (RIA) in December 2015, which included mandatory quantitative regulatory impact analysis for all new and amended draft legislation.

b. We are preparing a full-scale revision of regulatory norms, which includes (i) review of all norms that influence businesses; and (ii) preparing recommendations on whether the norm should be eliminated, revised or maintained. This review is expected to be finalized by end-December 2016 together with a roadmap for the implementation of these recommendations.

c. The Cabinet of Ministers will ensure that the recently adopted Law "On Licensing of Types Economic Activity" will be fully functional. To date, the Cabinet has already approved 13 licensing conditions (out of 30) and the remainder will be adopted by end-September 2016. Delays in submission or approval of these rules and conditions will not serve as a basis for denying a license or for prohibition of business activities.

d. The Cabinet of Ministers, in consultation with the IMF, we will submit a draft law on agricultural land circulation to parliament by end-September 2016 (a **new structural benchmark**). Parliamentary approval of the law is expected by end-December 2016.

State-owned enterprise reforms

39. We continue to press ahead with the implementation of the SOE-reform strategy. Key elements of our strategy include (i) improving budgetary oversight, specifically by enhancing the SOEs fiscal-risk assessment; (ii) improving governance of SOEs; and (ii) implementing transparent privatization, restructuring, or liquidation of identified SOEs in the medium run. Specific near-term measures include:

a. *SOE fiscal risk assessment*:

- We have established an inter-departmental working group to improve the methodology for assessing fiscal risks emanating from SOEs liabilities. In this context, we have identified the list of the 10 SOEs posing the biggest fiscal risks that will be subject to restructuring. Furthermore, we have developed, in consultation with IMF staff, a reporting template to facilitate the stocktaking of SOEs arrears. On this basis, we have extended the coverage of the SOEs reporting to include all arrears of the 50 largest companies and have prepared reports on the stock of these arrears.

- Building on these efforts and as part of our strategy to improve fiscal risk management, we are establishing a fiscal risks management unit in the Ministry of Finance. Through this unit, the Ministry of Finance will put in place SOE fiscal risks monitoring and analysis framework and will use the analysis to inform the budget preparation process and provide for any expected fiscal impact on the budget. In line with recent IMF TA recommendations, we will ensure that the new unit is only responsible for monitoring and analysis and does not interfere in any form in the management of SOEs or exert additional control over SOE operations. After the unit has been established, we will prepare a comprehensive statement of fiscal risks emanating from the SOE sector to be included in budget documentation and published on the Ministry of Finance website. After the ministry of finance develops the capacity to manage fiscal risks from SOEs we will expand the analysis to the wider portfolio of fiscal risks facing Ukraine, such as general macroeconomic risks and commodity prices risks.

b. *SOE governance*:

- The Law "On Amendments to Some Legislative Acts of Ukraine on Corporate Governance of State Property," aimed at strengthening the SOEs governance structure and enhancing the transparency of their operations has been adopted. The law allows for the introduction of supervisory boards at fully state-owned enterprises and makes external audits obligatory for these enterprises. To enable its proper implementation and with a view to introducing independent supervisory boards in the largest unitary SOEs, the Cabinet of Ministers will adopt by end-September 2016 a decision that will regulate the process of establishing such supervisory boards, selecting its members, and other procedural matters. Thereafter, we will appoint independent supervisor boards in at least five large SOEs by end-October 2016 and in at least 10 more large SOEs by end-December 2016. First audit reports for these companies based on end-2015 financial results will be completed by end-October 2016.

- In particular, we appointed the independent supervisory board of Naftogaz, consisting of five members, with three independent members and two members appointed upon nomination by the President and the Cabinet of Ministers of Ukraine, consistent with the Naftogaz Corporate Governance Action Plan.
- The Cabinet of Ministers adopted a decree establishing criteria for auditor selection in SOEs based on the SOE's size. We plan to have audit reports of 20 large SOEs completed and published in accordance to the decree by end-October 2016, and audit reports of at least 30 more large SOEs published by end-December 2016.
- The MEDT, in consultation with IMF staff, will develop by end-September 2016, a time-bound action plan that will outline: (i) the corporate governance structure of the single national Holding Company that will be tasked with managing strategic commercial SOEs, including nomination procedures for supervisory boards, CEO and executive board, authorities of the managing bodies and reporting lines and requirements, and (ii) steps required to establish the Holding Company, including the necessary legal framework, and the timeline thereof.

c. *Triage of all SOEs*.

- We are committed to the triage of all SOEs to determine their appropriate classification: keep under the management of the State (strategic commercial SOEs and SOEs that perform other strategic functions, including regulatory, social, and defense, and SOEs that are located in territories currently not under the control of the government), sell (privatization), or liquidate (liquidation or bankruptcy). In particular,
- The MEDT, in consultation with IMF staff, will complete a preliminary triage of all SOEs and reconcile it within the Cabinet of Ministers by end-September 2016. Within this stage, we will review the list of "strategic" companies and assess their proper qualification as "strategic," therefore not for sale.
- In parallel, we are reviewing and developing the necessary legal framework that would allow implementing the triage of all SOEs, including a significant reduction of the non-privatization list, establishment of a special unit within the State Property Fund of Ukraine (SPFU) tasked with the liquidation of non-operating SOEs, and development of streamlined procedures for the liquidation of certain non-operating SOEs.

- Following the above preparatory work, we will (i) aim to adopt amendments to the relevant legislation, that will allow for the implementation of the triage of all SOEs; (ii) complete the triage of all SOEs in consultation with IMF staff, other line ministries and governments agencies managing SOEs, which will be approved by Cabinet resolution. Moreover, we will transfer to the SPFU the SOEs incorporated in the privatization plan for 2016, except those that will remain in the list of companies banned from privatization. Cabinet adoption and publication in the MEDT website of the triage and transfer of SOEs to the SPFU will be completed by end-October 2016 (a **new structural benchmark**). Within this process, we are developing an action plan for privatization and liquidation of SOEs, including a phased schedule for transferring of SOEs to the SPFU to preserve sufficient institutional capacity at the SPFU.

d. *Restructuring and Liquidation*:

- Building on the list of those SOEs posing the biggest fiscal risks, we prepared, in agreement between the respective line ministry, Ministry of Economy and the Ministry of Finance, detailed restructuring action plans for fives of these companies (an end-January 2016 **structural benchmark**). The relevant line ministry together with the MEDT and Ministry of Finance will ensure adequate implementation of these restructuring plans.

- The government plans to centralize the liquidation of non-operating SOEs in one governmental body. With this intent, the SPFU, in consultation with relevant ministries and IMF staff, is preparing a draft law on liquidation of SOEs that will enable the SPFU to liquidate certain SOEs, those with zero assets or where assets are smaller than liabilities, under streamlined procedures. In this context, we will conduct an analysis of the bankruptcy law as relevant for SOEs and introduce the necessary changes where needed. We expect parliament adoption of this law by end-October 2016. We will also revise, by end-October 2016, secondary legislation that regulates the transfer of non-operating SOEs between Government bodies with the aim to simplify procedures for transferring of non-operating SOEs with zero assets, or where assets are smaller than liabilities, from line ministries and other managing authorities to the SPFU with the sole purpose of their liquidation. Moreover, we will ensure, in consultation with IMF staff, that the SPFU has sufficient institutional capacity to perform these duties, including adequate financial and human resources.

e. *Privatization*. We are committed to accelerate the privatization of SOEs, while ensuring an open and transparent process aimed at attracting strategic investors that will fully develop the potential of the privatized companies. In the meantime:

- The Cabinet of Ministers adopted a resolution identifying a list of SOEs subject to priority privatization with the participation of advisors. Building on this, we have adopted by Cabinet resolution action plans for these companies, which define for each SOE the key parameters and conditions of the process, including the timeline for divesting, method of privatization, and intermediate steps to be taken. The shares of all SOEs on the priority privatization list approved by the Cabinet of Ministers have now been transferred to the SPFU. Subsequently, we will initiate their privatization, taking the necessary steps to ensure an open and transparent process.

- In this context, Parliament adopted amendments to the privatization law to cancel mandatory sale of 5–10 percent of shares on stock exchange. The Cabinet of Ministers will adopt by end-September 2016 the necessary secondary legislation establishing the criteria for the selection of advisors for large SOEs (Group G).

- By end-September 2016, the Cabinet of Ministers will adopt the 2016 Privatization Plan. Parliament will also adopt by end-September 2016 legislation to reduce the list of companies banned from privatization, notably to remove seaports and agricultural SOEs from the list, which will form part of the 2016 Privatization Plan. Subsequently, the Cabinet of Ministers will adopt the necessary decisions to transfer all the shares of the companies included in the 2016 Privatization Plan to the SPFU. Transfer of these shares will be completed by end-October 2016.

- Furthermore, the MEDT and SPFU are preparing, in cooperation with the MoF, additional amendments to the privatization law to improve transparency and safeguards, and to further streamline the privatization process, including:

  i. A set of measures to prevent asset stripping in SOEs selected for privatization, by limiting the right of management of such SOEs to enter into (i) long term contractual obligations (in excess of 6 months), and (ii) transactions the value of which, individually or in the aggregate, exceeds a specific limit. These measures will provide for personal liability of SOE managers for breach of such obligations and the right for unwinding all affected contracts post-privatization. The only exception to the limitations under (i) and (ii) above will be where the relevant transaction receives a prior written consent from the SPFU;

  ii. Streamlined procedures for the privatization of small- and medium-sized SOEs;

iii. Comprehensive procedures for the privatization of large-scale SOEs in line with international best practices;

iv. Improved cooperation between the SPFU, law enforcement agencies, and regulatory authorities in the process of verification of information about interested buyers. We will complete these amendments, in consultation with IMF staff, submit to parliament by end-September 2016 and expect Parliament adoption by end-December 2016 (a **new structural benchmark**).

- We have made significant progress to ensure a robust and transparent privatization of PJSC Odessa Portside Plant, including the engagement of advisors, in accordance with international best practices, that have prepared and submitted to SPFU information packages for PJSC Odessa Portside Plant. Financial audits, based on end-December 2015 results and according to IFRS standards and the relevant environmental audits have also been completed. Furthermore, the Cabinet of Ministers approved conditions for the sale of the company, including the requirement that at least two bidders, at least one of them foreign, participate in the contest. We expect the SPFU to hold the auction by end-October 2016.
- Similarly, by end-2016, we aim to undertake contest sales of JSC Kharkivoblenergo, OJSC Zaporizhyaoblenergo, PJSC Mykolayivoblenergo, PJSC Khmelnytskoblenergo, OJSC Ternopiloblenergo, following the same procedures as for PJSC Odessa Portside Plant.
- We will aim to launch the privatization contest for PJSC Centrenergo and aim to complete its sale by end-March 2017, following the same procedures as for PJSC Odessa Portside Plant.

III. Program Monitoring

40. Implementation of the policies under the program will continue to be monitored through prior actions, quantitative performance criteria, indicative targets, continuous performance criteria, structural benchmarks, and quarterly reviews, as envisaged in our Memoranda of Economic and Financial Policies dated February 27 and July 21, 2015 along with this Memorandum. We also request to establish new indicative targets for the inflation rate. The attached Technical Memorandum of Understanding (TMU) defines the quantitative performance criteria and indicative targets under the program. The **prior actions** and **structural benchmarks** are set out in Table 1. The quantitative targets for target dates for end-September and end-December 2016 and end-March 2017, along with continuous quantitative performance criteria, and indicative targets for end-June 2017, are set out in Table 2b and the TMU.

Attachment I. Table 1. Ukraine: Prior Actions and Structural Benchmarks		
Proposed Prior Actions	**Status**	**Completion date**
Parliamentary approval of the 2016 budget in line with program commitments and of a new tax code (as described in ¶26, except the measures due after July 1, 2016).	Met	
Appointment of the Head Anticorruption Prosecutor and his/her two deputies (¶35e).	Met	
Adoption and publication of a Cabinet of Ministers decision to unify and increase the retail gas tariffs at a level consistent with 100 percent of cost recovery based on import parity, effective May 1, 2016 (as described in ¶33a).	Met	
Adoption and publication of necessary decisions to increase retail heating tariffs to 100 percent of the level consistent with gas priced at full import parity effective July 1, 2016 (as described in ¶33a).	Met	
Adopt a Cabinet of Ministers decree reducing the lists 1 and 2 of occupations eligible for early retirement by at least 40 percent in terms of eligible persons (¶29a).	Met	
Proposed New Structural Benchmarks	**Status**	**Completion date**
Adjust the parameters of the utility-related social assistance programs, including the HUS benefits formula, to ensure that benefits remain within the allocated fiscal envelope (¶31a).		End-September 2016
Submit law on agricultural land circulation to parliament (¶38d).		End-September 2016
Revise the Public Service Obligations (CMU Resolution 758) to introduce an interim mechanism to adjust gas and heating tariffs on a quarterly basis if tariffs deviate from full cost-recovery levels (based on import parity as defined in the TMU) by 10 percent or more (as described in ¶33a).		End-October 2016
Ensure all high-level officials filed their assets and income declarations, as defined under Article 46 of law 2014/49 for the calendar year 2015 and their full disclosures freely available to the public on a single website shortly after submission (¶36c).		End-October 2016
Cabinet of Ministers approval and publication in the MEDT website of the completed triage of all SOEs, dividing them into companies to (i) remain under management of the State (including SOEs that are located in territories currently not under the control of the government); (ii) privatize; or (iii) liquidate; and transfer to the SPFU those SOEs incorporated in the privatization plan for 2016 (¶39c).		End-October 2016

Attachment I. Table 1. Ukraine: Prior Actions and Structural Benchmarks (continues)

Proposed New Structural Benchmarks	**Status**	**Completion date**
Parliamentary approval of legislation ensuring that the NABU has: (i) the use of a wide range of investigative techniques, including undercover operations, intercepting communications, accessing computer systems and controlled delivery, without having to rely on other agencies' infrastructure; and that (ii) the registration of pre-court cases and of investigative judges' rulings pertaining to NABU should be protected from leakage of information related to ongoing investigations, by restricting access to the information to NABU and SAPO officers until the investigation of the case is completed, or the case is closed (¶36a).		End-November 2016
Parliamentary approval of legislation to: (i) gradually adjust the statutory retirement age and further reduce the scope for early retirement; (ii) tighten the eligibility criteria for the minimum pension; (iii) consolidate pension legislation, which is now spread across about two dozen laws, and ensure a single principle for providing pensions without privileges for any occupation (with the exception of the military); (iv) expand the base for social security contributions; (v) ensure equitable tax treatment of pensions; and (vi) better link benefits to contributions, also to encourage the declaration of actual incomes. In addition, we will separate various categorical pension supplements from the labor pensions, bring their financing from the pension fund to the state budget and improve their targeting starting from 2017 (¶29a).		End-December 2016
Parliamentary approval of amendments to the privatization law to improve transparency and safeguards, and to further streamline the privatization process (¶39e).		End-December 2016
Adopt legislation to merge the customs and tax administration into a single legal entity (¶27a).		End-December 2016
Previous Structural Benchmarks	**Status**	**Completion date**
NBU and Financial Sector		
NBU will notify banks of any identified discrepancies in the related-party exposure reports based on steps (i) and (ii) as described in February 2015 MEFP ¶13.	Met	End-July 2015
Parliament will approve amendments to legislation, consistent with IMF staff advice, to strengthen the corporate insolvency regime (July 2015 MEFP ¶17, modified this MEFP ¶20).	Not met	End-March 2016 Reset to end-September 2016
Fiscal Policy		
The State Fiscal Service will transfer all taxpayers meeting large taxpayer criteria to the LTO (February 2015 MEFP ¶22).	Met	End-December 2015
The State Fiscal Service will implement its new arrangements as specified under the revenue administration reform plan (February 2015 MEFP ¶25).	Met	End-December 2015

Attachment I. Table 1. Ukraine: Prior Actions and Structural Benchmarks (concluded)		
Previous Structural Benchmarks	**Status**	**Completion date**
Fiscal Policy		
Parliamentary passage of pension reform legislation, as agreed with IMF staff that revises the parameters of the pay-as-you-go system to make it more sustainable, abolishes special pensions, and lays the conditions for the adoption of a funded system that would complement the pay-as-you-go system (July 2015 MEFP ¶24).	Not met	End-December 2015 Revised and reset to end-December 2016
State-Owned Enterprises		
Adoption by a cabinet resolution of the privatization action plan for five large SOEs from the priority privatization list (July 2015 MEFP ¶30).	Met	End-September 2015
Agreement on detailed restructuring action plans, prepared in consultation with IMF staff, for five SOEs with the largest fiscal risks, between the respective line ministry, Ministry of Economy, and the Ministry of Finance (July 2015 MEFP ¶30).	Met	End-January 2016
Governance		
Parliament will approve a law which strengthens the provisions in the Code of Civil Procedure and the Code on Commercial Procedure on Order for Payment for domestic transactions and on garnishment of bank accounts (February 2015 MEFP ¶35; modified this MEFP ¶37a).	Not met	End-December 2015 Reset to end-September 2016
Establish a specialized anticorruption prosecution function in charge of overseeing NAB's investigations, in accordance with the Law on the Prosecutor's Office, and enable NAB timely access to relevant information from other public institutions (July 2015 MEFP ¶29).	Not met (prior action)	End-September 2015
Undertake measures to make the National Anti-Corruption Bureau operational, including with regard to its prosecutorial function (July 2015 MEFP ¶29).	Met	End-January 2016
Energy Sector		
Reform utility-related social assistance by (i) reducing the scope of energy privilege programs to cover only households that remain exempt from income testing according to Law 76-VIII/2014; (ii) converging the associated benefits to the levels in the HUS program; and (iii) revising the benefit formula of the expanded HUS program in consultation with IMF staff to channel benefits to vulnerable households and provide incentives for energy efficiency. The overall fiscal envelope for all energy-related social assistance programs (privileges and HUS) will be set at UAH 35 billion for 2016 (July 2015 MEFP ¶24, as revised in ¶31a of the current MEFP).	Not met	End-May 2016

Attachment I. Table 2a. Ukraine: Quantitative Criteria and Indicative Targets 1/

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

	2015						2016					
	September			December			March			June		
	PC	Adj. PC	Actual	PC	Adj. PC	Actual	IT	Adj. IT	Actual	IT	Adj. IT	Actual
I. Quantitative performance criteria												
Ceiling on the cash deficit of the general government (- implies a surplus) 2/	43,100	57,937	-6,344	82,700	119,320	59,470	12,700	20,694	5,196	32,400	30,822	18,815
Ceiling on the cash deficit of the general government and Naftogaz (- implies a surplus) 2/	97,100	95,682	13,512	144,600	162,632	77,644	5,700	10,754	-6,534	37,100	29,693	-8,735
Floor on cumulative change in net international reserves (in millions of U.S. dollars) 3/ 4/	-284	-471	-638	2,098	575	-576	2,224	127	-987	2,545	809	1,084
Ceiling on cumulative change in net domestic assets of the NBU 3/ 4/	84,571	87,856	-1,924	57,720	81,731	11,892	54,520	87,577	9,595	69,445	96,817	2,362
Ceiling on publicly guaranteed debt 2/	30,000	30,000	0	30,000	30,000	12,758	20,000	20,000	0	20,000	20,000	0
II. Continuous performance criterion												
Non-accumulation of new external debt payments arrears by the general government (millions of U.S. dollars) 2/ 5/ 6/	0	0	575	0	0	3,756	0	0	58	0	0	58
III. Indicative Targets												
Ceiling on cumulative change in base money 3/	80,086	80,086	-11,988	90,796	90,796	2,805	89,584	89,584	-5,974	109,578	109,578	19,455
Ceiling on net accumulation of VAT refund arrears 2/	0	0	4,322	0	0	121	0	0	1,299	0	0	2,935
IV. Memorandum Items												
Naftogaz deficit (- implies a surplus) 2/	54,000	37,745	19,855	61,900	43,312	18,173	-7,000	-9,940	-11,730	4,700	-1,129	-27,550
External project financing 2/	13,000		4,039	14,937		6,341	6,995		1,194	15,107		2,207
NBU loans to DGF and operations with government bonds issued for DGF financing or banks recapitalization 3/	53,000		34,771	55,000		51,450	55,000		51,450	55,000		51,365
Government bonds issued for banks recapitalization and DGF financing 2/	59,500		28,837	152,000		45,337	0		14,275	0		14,275
Programmed disbursements of international assistance except IMF (millions of U.S. dollars) 3/ 4/	3,504		3,220	5,475		3,462	6,204		3,771	6,204		3,801
Conversion of a non-reserve currency under a central bank swap line into a reserve currency through an outright sale 3/ 4/	0		0	0		0	0		0	0		0
Net financing from debt operations (millions of U.S. dollars) 3/ 4/	500		575	4,228		4,719	4,228		4,565	5,478		6,145
Purchases of foreign exchange from the NBU for the purposes of critical energy imports (incl. those of Naftogaz, millions of US dollars) 3/ 4/	1,686		1,664	1,686		1,686	1,686		1,686	1,686		1,686
NBU purchases of T-bonds issued by government for Naftogaz recapitalization 3/	28,300		29,939	28,300		29,939	28,300		29,939	28,300		29,939
Projected payments of interest on government bonds held by NBU 2/	30,300		30,410	41,800		42,874	10,600		11,128	21,800		24,914
Program accounting exchange rate, hryvnia per U.S. dollar	15.7686		15.7686	15.7686		15.7686	15.7686		15.7686	15.7686		15.7686

Sources: Ukrainian authorities; and IMF staff estimates and projections.
1/ Definitions and adjustors are specified in the Technical Memorandum of Understanding (TMU).
2/ Targets for 2015 are cumulative flows from January 1, 2015. For 2016, cumulative flows from January 1, 2016.
3/ Targets and projections for 2015 to June 2016 are cumulative flows from January 1, 2015.
4/ Calculated using program accounting exchange rates specified in the TMU.
5/ This entry is in accordance with the Technical Memorandum of Understanding between Ukraine and the IMF and is subject of ongoing litigation commenced by the creditor in the High Court in England.
6/ Arrears incurred in September 2015 were settled in December 2015 following a restructuring agreement. Arrears incurred in January 2016 were settled following a restructuring agreement in February 2016.

Attachment I. Table 2b. Ukraine: Quantitative Criteria and Indicative Targets 1/

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

	2016		2017	
	September	December	March	June
	PC	PC	PC	IT
I. Quantitative performance criteria				
Ceiling on the cash deficit of the general government (- implies a surplus) 2/	35,000	84,900	15,000	29,000
Ceiling on the cash deficit of the general government and Naftogaz (- implies a surplus) 2/	30,500	90,000	-1,100	25,400
Floor on cumulative change in net international reserves (in millions of U.S. dollars) 3/ 4/	1,776	2,317	2,288	3,498
Ceiling on cumulative change in net domestic assets of the NBU 3/ 4/	-2,886	9,923	22,584	32,075
Ceiling on publicly guaranteed debt 2/	28,200	28,200	15,000	15,000
II. Continuous performance criterion				
Non-accumulation of new external debt payments arrears by the general government (millions of U.S. dollars) 2/	0	0	0	0
III. Indicative Targets				
Ceiling on cumulative change in base money 3/	25,123	46,452	58,655	87,233
Ceiling on stock of VAT refund arrears 2/	0	0	0	0
Inflation (mid-point, percent) 5/	n.a.	12.0	12.0	12.0
Ceiling on current primary expenditure of the state budget 2/	n.a.	526,000	n.a.	n.a.
IV. Memorandum Items				
Naftogaz deficit (- implies a surplus) 2/	-4,500	5,100	-16,100	-3,600
External project financing 2/	8,965	15,858	4,000	8,000
NBU loans to DGF and operations with government bonds issued for DGF financing or banks recapitalization 3/	-635	-635	455	1,608
Government bonds issued for banks recapitalization and DGF financing 2/	166,000	166,000	6,000	12,000
Programmed disbursements of international assistance except IMF (millions of U.S. dollars) 3/ 4/	1,339	2,404	2,529	3,283
Conversion of a non-reserve currency under a central bank swap line into a reserve currency through an outright sale 3/ 4/	0	0	0	0
Net financing from debt operations (millions of U.S. dollars) 3/ 4/	1,237	2,467	2,199	2,470
Projected payments of interest on government bonds held by NBU 2/	36,056	49,294	10,585	22,880
Net issuance of central government domestic FX debt 3/	455	-38	-99	-156
Program accounting exchange rate, hryvnia per U.S. dollar	15.7686	15.7686	15.7686	15.7686

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

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

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

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

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

5/ End of period, year-on-year headline inflation. Mid-point within a +/- 3 percent range.

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

Availability date	Amount of purchase: Millions of SDRs	Millions of US$ 1/	Percent of quota 2/	Conditions
March 11, 2015	3,546.000	4,872.00	258.45	Board approval of extended arrangement
June 15, 2015 3/	1,182.100	1,650.00	86.16	First review and end-March 2015 performance criteria
September 15, 2015	716.110	1,000.00	52.19	Second review and end-December 2015 performance criteria
November 15, 2016	952.487	1,330.88	47.35	Third review and end-September 2016 performance criteria
February 15, 2017	1,418.479	1,985.90	70.51	Fourth review and end-December 2016 performance criteria
May 15, 2017	952.487	1,333.59	47.35	Fifth review and end-March 2017 performance criteria
August 15, 2017	952.487	1,333.56	47.35	Sixth review and end-June 2017 performance criteria
November 15, 2017	525.570	735.83	26.12	Seventh review and end-September 2017 performance criteria
February 15, 2018	525.570	735.42	26.12	Eight review and end-December 2017 performance criteria
May 15, 2018	525.570	735.67	26.12	Ninth review and end-March 2018 performance criteria
August 15, 2018	525.570	736.08	26.12	Tenth review and end-June 2018 performance criteria
November 15, 2018	525.570	736.08	26.12	Eleventh review and end-September 2018 performance criteria
Total	12,348	17,185	614	

Source: IMF staff estimates.

1/ For 2015–18, the average USD/SDR rates used in this table are: 1.402, 1.397, 1.400, and 1.400, respectively.

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

3/ The second purchase took place on August 4, 2015.

Attachment II. Ukraine: Technical Memorandum of Understanding

September 1, 2016

1. This Technical Memorandum of Understanding (TMU) sets out the understandings between the Ukrainian authorities and IMF staff regarding the definitions of the variables subject to quantitative targets (performance criteria and indicative targets) for the economic program supported by the Extended Arrangement under the Extended Fund Facility, as described in the authorities' Letter of Intent (LOI) dated September 1, 2016 and the attached Memorandum of Economic and Financial Policies (MEFP). It also describes the methods to be used in assessing the program performance and the information requirements to ensure adequate monitoring of the targets.

2. Prior actions and structural benchmarks are listed in Table 1 of the MEFP, with corresponding definitions in Section I below. The quantitative performance criteria are shown in Table 2 of the MEFP. The definitions of these quantitative targets and the adjustment mechanisms are described in Section I below. The official exchange rate is defined in Section II. Reporting requirements are specified in Section III.

3. For the purposes of the program, all exchange rates used to evaluate reserve levels and monetary aggregates are (i) the official exchange rate of the Ukrainian hryvnia to the U.S. dollar of 15.7686 set by the NBU as of December 31, 2014; and (ii) reference exchange rates of foreign currencies reported by the European Central Bank (ECB) on its web site as of December 31, 2014, which the NBU used to set official exchange rates of hryvnia to those currencies. In particular, the Swiss Franc is valued at 0.9904 per dollar, the Euro is valued at 1.2141 dollars, the Pound Sterling is valued at 1.5587 dollars, the Australian dollar is valued at 0.8187 U.S. dollars, the Canadian dollar is valued at 0.8633 dollars, the Chinese Yuan is valued at 0.1611 U.S. dollars, the Japanese yen is valued at 119.6195 per dollar, and the Norwegian Krone is valued at 0.1343 dollars. The accounting exchange rate for the SDR will be 0.690224 per dollar. Official gold holdings were valued at 1,206.00 dollars per fine ounce. These accounting exchange rates are kept fixed over the program period. Therefore, the program's accounting exchange rate differs from the actual exchange rate set in the foreign exchange market of Ukraine. Furthermore, setting a program exchange rate for the purpose of computing monetary aggregates does not imply that there is any target exchange rate for policy purposes.

4. For the purpose of the program, gross domestic product is compiled as per the System of National Accounts 2008 and excludes Crimea and Sevastopol.

I. Quantitative Performance Criteria, Indicative Ceilings, and Continuous Performance Criteria

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

Definition

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

6. Usable gross international reserves comprise all readily available claims on nonresidents denominated in convertible foreign currencies, consistent with the Balance of Payments Manual (Sixth Edition) and the Special Data Dissemination Standard (SDDS) (Table 6.1, item A). Excluded from usable reserves, *inter alia*, are:

- any assets denominated in foreign currencies held at, or which are claims on, domestic institutions (i.e., institutions headquartered domestically, but located either domestically or abroad, or institutions headquartered abroad, but located domestically). Also excluded are all foreign currency claims of the NBU on domestic banks, and NBU deposits held at the Interbank Foreign Currency Exchange Market and domestic banks for trading purposes;

- any precious metals or metal deposits, other than monetary gold and gold deposits, held by the NBU;

- any assets that correspond to claims of commercial banks in foreign currency on the NBU and any reserves assets that are (i) encumbered; or (ii) pledged as collateral (in so far as not already included in foreign liabilities, or excluded from reserve assets); or (iii) frozen; and

- any reserve assets that are not readily available for intervention in the foreign exchange market, *inter alia*, because they are not fully under the control of the NBU or because of lack of quality or lack of liquidity that limits marketability at the book price.

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

- all short-term liabilities of the NBU vis-à-vis nonresidents denominated in convertible foreign currencies with an original maturity of one year or less;

- the stock of IMF credit outstanding;

- the nominal value of all derivative positions[1] (including swaps, options, forwards, and futures) of the NBU and general government, implying the sale of foreign currency or other reserve assets; and

- all foreign exchange liabilities of the NBU to resident entities (e.g., claims in foreign exchange of domestic banks, and NBU credits in foreign exchange from domestic market) excluding foreign exchange liabilities to the general government, or related to deposit guarantees.

Attachment II. Table A. Components of Net International Reserves

	Type of Foreign Reserve Asset or Liability[1]	NBU Balance Sheet and Memorandum Accounts
1.	**International reserves**	
	Monetary gold	1100, 1107
	Foreign exchange in cash	1011, 1017
	Demand deposits at foreign banks	1201, 1202
	Short-term time deposits at foreign banks	1211
	Long-term deposits at foreign banks	1212
	SDR holdings and Reserve Position in the IMF	IMF, Finance Department[2]
	Securities issued by nonresidents	1300, 1305, 1307, 1308, minus 1306
	Settlement of foreign securities	2746, minus 4746
2.	**Short-term liabilities to nonresidents** *(in convertible currencies)*	
	Correspondent accounts of nonresident banks	3201
	Short-term deposits of nonresident banks	3211
	Operations with nonresident customers	3230, 3232, 3233, 3401, 8805
	Operations with resident banks	8815
	Use of IMF credit	IMF, Finance Department

1/ The definitions used in this technical memorandum will be adjusted to reflect any changes in accounting classifications introduced during the period of the program. The definitions of the foreign accounts here correspond to the system of accounts in existence on December 31, 2014. The authorities will inform the staff before introducing any change to the Charts of Accounts of the NBU and the Commercial Banks, and changes in the reporting forms.
2/ Before receiving the monthly data from the IMF's Finance Department, these components will be calculated on the basis of preliminary data from the NBU and memorandum accounts.

Assumptions in line with the authorities' commitments

8. The NIR/NDA targets assume a rollover of central government's domestic foreign exchange debt liabilities of 110 and 82 percent in 2016 and 2017, respectively. The rollover will be achieved through an issuance of new central government foreign exchange bonds with a maturity of at least one year. Furthermore, the NIR/NDA targets assume that there will be no early repayment of domestic foreign exchange bonds, in line with the authorities' commitment.

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

Adjustment mechanism

- The NIR targets will be adjusted upward (downward) by the full amount of the cumulative excess (shortfall) in program disbursements relative to the baseline projection (Table B). Program disbursements are defined as external disbursements (including grants and long-term credit to the National Bank of Ukraine, while excluding project-financing disbursements) from official multilateral creditors (World Bank, European Commission, European Investment Bank, and European Bank for Reconstruction and Development), official bilateral creditors (net), and external bond placements that are usable for the financing of the central government budget deficit or reserve assets.

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

- In case the NBU converts Renminbi or any other non-reserve currency provided under a central bank swap agreement with the NBU into a reserve currency through an outright sale, a symmetric adjustor will be applied to NIR targets. NIR targets will be adjusted upward by the amount that will be converted into a reserve currency at the time of the conversion. NIR targets will be adjusted downward by the amount of a reserve currency (both the principal and interest due), when the NBU repays the non-reserve currency provided under a central bank swap agreement.

- In the event of higher (lower) net financing from the debt operations than envisaged under the baseline (Table D), either due to the discontinuation of payments or due to changes to the terms resulting from the issuance of new debt upon completion of the debt operation on general government direct and guaranteed debt included in the perimeter of the debt operation as published in the Cabinet of Minister's Resolution No. 318-p on April 4, 2015, NIR targets will be adjusted upward (downward) by the full amount of the cumulative excess (shortfall) in net financing in foreign exchange relative to the baseline.

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

(Cumulative flows from end-December 2015, millions of U.S. dollars at program exchange rate)

	Eurobond placement	World Bank	EU	Others (Japan, Sweden, Switzerland, Turkey)	Total
End-September 2016	1,000	30	0	309	1,339
End-December 2016	1,000	40	930	434	2,404
End-March 2017	1,000	40	930	559	2,5293,28
End-June 2017	1,000	40	1,658	584	3

Attachment II. Table C. Net Issuance of Central Government Domestic FX Debt: Projections for NIR/NDA Adjustment

(Cumulative flows from end-December 2015, millions of U.S. dollars at program exchange rate)

	Net issuance
End-September 2016	455
End-December 2016	-38
End-March 2017	-99
End-June 2017	-156

Attachment II. Table D. Net Financing from Debt Operations: Projections for NIR/NDA Adjustment

(Cumulative flows from end-December 2015, millions of U.S. dollars at program exchange rate)

	Net Financing
End- September 2016	1,237
End-December 2016	2,467
End-March 2017	2,199
End-June 2017	2,470

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

Definition

9. Net domestic assets (NDA) of the NBU are defined as the difference between the monetary base (as defined below) and the NIR of the NBU (as defined above, excluding the conversion of a non-reserve currency to a reserve currency through an outright sale under a central bank swap agreement of exchange of deposits). For the purpose of computing the NDA target, the NIR is valued at the program exchange rates defined in paragraph 3 and expressed in hryvnia.

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 by the full amount of the cumulative excess in the total amount of NBU loans to the Deposit Guarantee Fund (DGF) as well as total amount of NBU purchases of government bonds issued for the purposes of DGF financing, and NBU purchases of government bonds issued for bank recapitalization (all combined up to a limit of UAH 166 billion) and UAH 12 billion in 2016 and January through June 2017, respectively), relative to the baseline projection, and evaluated at the program exchange rates if provided in foreign exchange (Table E).

- In case another central bank uses the hryvnia provided under a central bank swap agreement with the NBU, a symmetric adjustor will be applied to NDA targets. NDA targets will be adjusted upward by the amount of hryvnia placed in a commercial bank's account at the NBU, when the central bank uses the hryvnia. NDA targets will be adjusted downward by the amount of hryvnia (both the principal and interest due), when the other central bank repays the used hryvnia.

- In the event of higher (lower) net financing from debt operations than envisaged under the baseline (Table D), either due to the discontinuation of payments or due to changes to the terms resulting from the issuance of new debt upon completion of the debt operation on general government direct and guaranteed debt included in the perimeter of the debt operation as published in the Cabinet of Minister's Resolution No. 318-p on April 4, 2015, NDA targets will be adjusted downward (upward) by the full amount of the cumulative excess (shortfall) in net financing in foreign exchange relative to the baseline and evaluated at the program exchange rates.

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

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

(Cumulative flows from end-December 2015, 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
End-September 2016	-635	0
End-December 2016	-635	0
End-March 2017	455	0
End-June	1,607	0

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

Definition

10. The NBU's monetary base comprises domestic currency outside banks and banks' reserves, including cash in vault of commercial banks, and funds of customers at the NBU.[2] Currency outside banks is defined as Currency—banknotes and coins—(NBU accounts 3000 (net)+3001 (net)-3007A-3009A-1001A-1004A-1007A-1008A-1009A) minus cash in vault at deposit money banks (DMBs) (DMB accounts 1001A:1005A, and 1007A). Banks' reserves are defined as cash in vault at deposit money banks (DMB accounts 1001A:1005A, and 1007A) plus DMB correspondent account deposits at the NBU in hryvnia (NBU liabilities accounts 3200, 3203, and 3204)[3] plus funds of customers at the NBU in hryvnia (NBU liabilities accounts of groups 323,[4] 3250, 4731, 4732, 4735, 4736, 4738, 4739, and 4750), plus accrued interest on time deposits of DMBs in national currency (NBU accounts 3208L), plus accrued interest on client's current accounts in national currency.

Adjustment mechanism

- Consistent with the NDA target adjustment mechanism (as defined above), monetary base targets will be adjusted upward by the full amount of the cumulative excess in the total amount of NBU loans to the Deposit Guarantee Fund (DGF) as well as total amount of NBU purchases of government bonds issued for the purposes of DGF financing or banks recapitalization (all combined up to a limit of UAH 166 billion in 2016 and UAH 12 billion in 2016 and January through June 2017, respectively), relative to the baseline projection (Table D), and evaluated at the program exchange rates if provided in foreign exchange.

- Consistent with the NDA target adjustment mechanism (as defined above), monetary base targets will be adjusted upward by the amount of hryvnia placed in a commercial bank's account at the NBU, when another central bank uses the hryvnia provided under a central banks swap

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

[3] Previously included account 3206.

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

agreement. Monetary base targets will be adjusted downward by the amount of hryvnia (both the principal and interest due), when the other central bank repays the used hryvnia.

D. Headline Inflation (Indicative Target)

Definition

11. Headline inflation is defined as the year-on-year rate of change of the Consumer Price Index as measured by Ukraine's State Statistics Service. The indicative target will be considered met if headline inflation falls within a range of +/- 3 percentage points around the mid-point target in 2016 and 2017.

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

Definition

12. The general government comprises the central (state) government, including the Road Fund (UkrAvtoDor), all local governments, and all extra budgetary funds, including the Pension Fund, Unemployment Fund, and the Fund for Social Insurance of Ukraine (formerly temporary disability insurance and occupational injury and disease insurance funds). The budget of the general government comprises (i) the state budget; (ii) all local government budgets; and (iii), if not already included in (i), the budgets of the extra budgetary funds listed above, as well as any other extra budgetary funds included in the monetary statistics compiled by the NBU. The government will inform the IMF staff of the creation or any pending reclassification of any new funds, programs, or entities, immediately. The cash deficit of the general government is measured by means of net financing flows excluding the impact of valuation changes as:

- total net treasury bill sales[5] (in hryvnias and foreign currency) as measured by the information kept in the NBU registry of treasury bill sales (net treasury bill sales are defined as the cumulative total funds realized from the sales of treasury bills at the primary auction and government securities issued for recapitalization of banks and SOEs, less the cumulative total

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

redemption of principal on treasury bills), excluding bonds issued to recapitalize Naftogaz[6] and other SOEs; plus

- other net domestic banking system credit to general government as measured by the monetary statistics provided by the NBU (this consists of all non-treasury-bill financing in either domestic or foreign currency extended to the general government by banks less the change in all government deposits in the banking system) as well as any other financing extended by entities not reflected by the monetary statistics provided by the NBU; plus

- total receipts from privatization received by the State Property Fund and local governments (including the change in the stock of refundable participation deposits and the net sale of nonfinancial assets) and the proceeds from uncompensated seizures; plus

- the difference between disbursements and amortization on any bond issued by the general government or the NBU to nonresidents for purposes of financing the deficit of the general government; plus

- the difference between disbursements of foreign credits to the general government (including project loans on lent to public enterprises) and the amortization of foreign credits by the general government (including on lent project loans); plus

- the net sales of SDR allocation in the SDR department; plus

  - the net change in general government deposits in nonresident banks, or other nonresident institutions; plus

  - net proceeds from any promissory note or other financial instruments issued by the general government.

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

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

exclude VAT accounts used for electronic administration and escrow accounts of taxpayers used for customs clearance.

Adjustment mechanism

- The ceiling on the cash deficit of the general government is subject to an automatic adjustor based on deviations of external project loans (defined as disbursements from bilateral and multilateral creditors to the consolidated general government for specific project expenditure) from program projections (Table F). Specifically, if the cumulative proceeds from external project financing (in hryvnia evaluated at actual exchange rates):

  a. exceed program projections, the ceiling on the consolidated general government deficit will be adjusted upward by 100 percent of the excess in external project financing; and

  b. fall short of program projections, the ceiling on the consolidated general government deficit will be adjusted downward by 100 percent of the shortfall in external project financing.

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

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

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

	External project financing (Technical assumption for the adjustor purpose)	Budget support grant (Technical assumption for the adjustor purpose)
End-September 2016	8,965	0
End-December 2016	15,858	5,057
End-March 2017 1/	4,000	0
End-June 2017 1/	8,000	0

1/ Cumulative from January 1, 2017.

- 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 of UAH 166 billion in 2016 and UAH 42 billion in 2017. The amount included in the targets is zero, and indicative cumulative amounts for bank recapitalization/DGF-financing are presented in Table 2 of the MEFP.

- The ceiling on the cash deficit of the general government is subject to an automatic adjustor on the stock of budgetary arrears on social payments. Budgetary arrears on social payments comprise all arrears of the consolidated budget on wages, pensions, and social benefits owed by the Pension Fund, and the central or local governments. Budgetary arrears are defined as payments not made thirty days after they are due. Wages are defined to comprise all forms of remuneration for work performed for standard and overtime work. Pension obligations of the Pension Fund comprise all pension benefits and other obligations of the Pension Fund. This definition excludes unpaid pensions to individuals who resided or continue to reside on the territories that are temporarily outside the government control.

- The ceiling on the cash deficit of the general government will be automatically adjusted downward by VAT refund arrears accumulated as defined in Section E from January 1, 2016.

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

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

Cumulative flows from January 1, 2016	In billions of hryvnia
End-September 2016	36.1
End-December 2016	49.3
End-March 2017 1/	10.6
End-June 2017 1/	22.9

1/ Cumulative from January 1, 2017.

F. Ceiling on VAT Refund Arrears (Indicative Target)

15. 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). In 2016 and 2017, this time period is 74 days, allowing for verification of the validity and payment processing of claims.

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

16. The ceiling on the state budget current primary expenditure is defined as current cash expenditure of the general fund of the central (state) government of Ukraine net of interest

payments on domestic and external debt and plus payments of any past expenditure arrears. The ceiling is based on the definition as reported in the monthly treasury report (Kv_1ek) adjusted for Ukravtodor debt repayment.

17. 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 thirty days after they are due.

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

Definition

18. 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.

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

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

- net receipts from sale of financial assets (including recapitalization or other form of treasury securities issued to Naftogaz, irrespective of their issuance date); plus
- any other forms of financing of the company not identified above.

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

Adjustment mechanism

- All the adjustors as specified in section E. for the Cash Deficit of the General Government also apply to the general government component of this ceiling on the cash deficit of the general government and Naftogaz.
- The ceiling on the cash deficit of the general government and Naftogaz will be adjusted upward by the amount of loan financing by multilateral institutions and official bilateral creditors disbursed to Naftogaz for investment projects.
- The ceiling on the cash deficit of the general government and Naftogaz will be adjusted downward by the net transfers made by Gazprom (advance transit fee). These transfers are measured on a cumulative basis from the beginning of each calendar year.
- The ceiling on the cash deficit of the general government and Naftogaz will be adjusted by the net amount of accumulated domestic arrears by Naftogaz to Ukrgazvydobuvannya and Ukrtransgaz, measured on a cumulative basis from the beginning of 2015.

I. 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 non-residents, which has not been made within seven days after falling due (including grace period, if any). This includes direct and guaranteed debt by the general government. The general government is defined for the purposes of this performance criterion in section E paragraph 12 above. For the purposes of the performance

criterion on the non-accumulation of new external payments arrears by the General Government, arrears resulting from nonpayment of debt service for which a clearance framework has been agreed or for which a restructuring agreement is being sought are excluded from this definition. The performance criterion will apply on a continuous basis throughout the program period.

J. Ceiling on Publicly Guaranteed Debt (Performance Criterion)

Definition

22. The ceiling on publicly guaranteed debt will apply to the amount of guarantees issued in 2016 by the central (state) government. The official exchange rate will apply to all non-UAH denominated debt. New state guarantees in 2016 will amount to no more than UAH 28.2 billion. This ceiling excludes guarantees issued by the Ministry of Finance for NBU borrowings from IMF.

K. Other Continuous Performance Criteria

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

II. Official Exchange Rate

Determination of the Official Exchange Rate

24. The NBU will, on a daily basis, set the official rate calculated as a weighted average of the exchange rates of the interbank market deals on the same day. To calculate the official exchange rate, all deals concluded until 5:30pm on the day will be considered regardless of the settlement date. Specifically, tod, tom and spot (T+2) deals will be included. NBU will make public its official exchange rate by no later than 18:00 of the day, preceding the one for which it is set.

III. Cost Recovery of Gas and Heating Tariffs

25. The threshold deviation from cost recovery based on import parity to trigger a quarterly adjustment in retail gas and heating tariffs will apply to the commodity gas price, which is defined as the weighted monthly average of Naftogaz import prices (inclusive of transportation and entry

costs) from the date of the last adjustment to the date of calculation, multiplied by the spot US$/euro and UAH/US$ exchange rates on the date of calculation. The date of calculation shall be two months prior to the effective date of the adjustment (i.e., November 1, 2016 for the January 1, 2017 adjustment). Retail gas and heating tariffs would add to the commodity gas price the appropriate transmission costs (Ukrtransgas), distribution costs (oblgases), provider mark-up, and VAT in effect at the date of calculation as officially published by the regulator.

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 a other depository corporations (banks) according to the standardized reporting forms (SRFs), no later than the 25th 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 currency composition of reserve assets and liabilities.

28. The NBU will provide the IMF on a daily basis with information on obligatory, voluntary and total foreign exchange sales (including total from non-residents 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 Group 1.

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 depository guarantee fund (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 (form N 538).

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 Group 1. On a monthly

basis, foreign assets will be broken down by type (i.e., cash and deposits, government securities, nongovernment securities, loans, other) and foreign liabilities by type, holder (i.e., banks, other financial institutions, nonfinancial corporate, and individuals) and remaining maturity (less than one month, one to three months, three to 12 months and over 12 months). For foreign credit lines from banks and for securities, the rollover rates will also be provided.

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, Group 1 and Group 2 separately (all excluding banks in temporary administration) on the liquidity ratio and amounts of cash and cash equivalents, available funds in NBU accounts (excl. reserve requirements), correspondent accounts with well-known international banks (excl. encumbered accounts), and deposits from customers. The NBU will also provide, on a daily basis, bank-by-bank data for State Participation Group, Foreign Banking Group, and Group 1 banks and aggregate for Group 2, total assets and liabilities; loans and claims (by households, legal entities, and banks); and foreign exchange net open position. The data will be reported by domestic and foreign currency. The deposits data will be reported by households and legal entities and by maturity (current accounts, saving accounts, and time deposits). In addition, for the aggregate of the banking sector as well as Groups of banks, the NBU will provide data on deposits and credits excluding those banks in liquidation since 2014.

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 Group 1 banks the average interest rate on deposits to customers (by domestic and foreign currency, and legal entities and households, and by maturity—demand, savings, and time accounts); and on a weekly basis, the average interest rate on interbank borrowings (by domestic and foreign currency, and by maturity—overnight, 1–7 days, and over one week).

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 Group 1 banks—risk weighted assets and other risk exposures (for ratio

H2 calculation), including for the excess of long-term asset to funding and foreign exchange open position; total regulatory (Tier 1 and Tier 2) and core (Tier 1) capital; capital adequacy ratio for total regulatory (H2) capital; loans and claims by maturity buckets for households, legal entities, and banks in domestic and foreign currencies; deposits by maturity buckets for households, legal entities, and banks in domestic and foreign currencies; and foreign exchange net open position, split between total foreign exchange assets (long position) and foreign exchange liabilities (short position), and between on- and off- balance sheet.

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 Group 1 banks the amount of loans and claims (by households in domestic and foreign currency, legal entities in domestic and foreign currency, banks in domestic and foreign currency, maturity, and by loan classification categories I, II, III, IV, and V); collateral for loans and claims (by type of collateral, legal entities in domestic and foreign currency, households in domestic and foreign currency, banks in domestic and foreign currency, and by loan classification categories I, II, III, IV, and V); provisions on loans and claims (by households in domestic and foreign currency, legal entities in domestic and foreign currency, banks in domestic and foreign currency, and by loan classification categories I, II, III, IV, and V); large exposures (loans equal to or greater than 10 percent of equity), refinanced loans, and restructured loans (by households, legal entities, and banks); the average interest rate on the outstanding stock of loans to customers (by legal entities and households; accrued interest on loans (by domestic and foreign currency); securities held for trading and available for sale, with government securities reported separately (by domestic and foreign currency); securities held to maturity and as investment, with government securities reported separately (by domestic and foreign currency).

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 Group 1 banks the amount of deposits of related parties (by domestic and foreign currencies, and households and legal entities); deposits of related parties pledged as (cash cover) collateral (by domestic and foreign currencies, and households and legal entities); other liabilities to related parties (by domestic and foreign currencies); related party loans (by households, legal entities, and banks); counterparty names and amounts of the largest 20 loans to related parties; collateral for loans and claims on related parties (by type of collateral, legal entities, households, and banks in domestic and foreign currencies, as well as by loan classification categories I, II, III, IV, and V); provisions on loans and claims on related parties (by households, legal entities, and banks in domestic and foreign currencies, as well as by loan classification categories I, II, III, IV, and V).

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 Group 1 banks on cumulative income statements, including total revenues; interest revenues (from loans to households, loans to legal entities, interbank loans, placements with the NBU, securities); revenues from fees and commissions; total expenses; interest expenses (on deposits to legal entities, deposits to households, interbank borrowing, borrowing from NBU, securities issued); fees and commissions paid; salaries and other staff compensation; other operational expenses; net earnings before loan loss provisions; loan loss provisions; net earnings after loan loss provisions; taxes paid; net earnings.

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 Group 1 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 Group 1 banks' regulatory capital has been increased. The report will disclose the instrument or transactions by which the regulatory capital has been increased (e.g., capital injection, conversion of subordinated debt to equity etc.).

51. The NBU will, once a month, inform the IMF any regulatory and supervisory measures against banks violating the NBU regulations on capital adequacy, liquidity ration, large exposures, and 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, 2016 on its portfolio of government bonds on a monthly basis but no later than 15 days from the end of the reporting period. Monthly, the NBU will also provide data on the monthly coupons and principal to be paid (in hryvnia and foreign currency, separately) on the outstanding stock of government securities held by NBU and the public.

B. Deposit Guarantee Fund

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, Deposit Guarantee Fund, and Agrarian Fund) that is guaranteed by the government (amount of sovereign guarantees extended by executive resolutions and actually effectuated; total amount of outstanding guarantees and list of their recipients) on a monthly basis no later than 25 days after the end of the month.

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

78. 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.

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

80. 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										

81. 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.

82. 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.

83. 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.

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

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

85. The Ministry of Economy will provide quarterly information on actual levels of communal service tariffs in all regions for major services (heating, water supply, sewage and rent) and their level of cost recovery. In addition, the Ministry of Economy, the Ministry of Housing and Municipal

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

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

87. For each month, no later than the 25th of the following month, the Ministry of Economic Development and Trade (based on information by Naftogaz) will provide IMF staff with information in electronic form (in an agreed format) on the cash flows and deficit of the company, as defined above. This report will break down the total cash outlays for gas imports from Gazprom by month in a separate table mutually agreed with IMF staff.

88. For each month, no later than the 25th of the following month, the Ministry of Economic Development and Trade (based on information by Naftogaz) will provide IMF staff with information in electronic form in an agreed format on the domestic gas used by Naftogaz for sales to households, heating utilities, budget institutions, and industries, including gas produced by SC "Ukrgasvydobuvannya," and OJSC "Ukrnafta."

89. 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.

90. 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).

91. 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.

92. The Ministry of Economic Development and Trade (based on information by Naftogaz) will report on a weekly basis data on Naftogaz daily market purchases of foreign exchange.

93. 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

94. 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

95. The Ministry of Social Policy will collect and submit to IMF and World Bank staff on a monthly basis data on HUS and privileges for energy consumption. The data, which will be presented in an agreed excel format, will show for each program (a) the number of households which applied for HUS; (b) number of approvals extended to such HUS applications; (c) number of households-recipients of HUS and privileges in the reporting month; (d) total value of transfers; (e) number of refusals extended to such applications; (f) income per capita of participants, both for HUS and privileges; (g) number of household members; and (h) main reasons for refusal for HUS application (e.g., lack of residency information) and are to be presented by overall, by region and for rural/urban areas.

G. National Anti-Corruption Bureau

96. 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 (Article 216.1.1 CPP)	Judges (article 216.1.4 CPP)	Prosecutors (Article 216.1.5 CPP)	Category A Civil Servants (Article 216.1.2 CPP)	SOE Managers (Article 216.1.8 CPP)	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 (Article 216.1.1 CPP)		Judges (article 216.1.4 CPP)		Prosecutors (Article 216.1.5 CPP)		Category A Civil Servants (Article 216.1.2 CPP)		SOE Managers (Article 216.1.8 CPP)		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 (Article 216.1.1 CPP)		Judges (article 216.1.4 CPP)		Prosecutors (Article 216.1.5 CPP)		Category A Civil Servants (Article 216.1.2 CPP)		SOE Managers (Article 216.1.8 CPP)		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).

97. 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 reports received by the Financial Intelligence Unit (FIU)in relation to suspicions of laundering of the proceeds of corruption, in the following format:

Reports received by NABU from FIU

	Members of Parliament, Members of the Government (Article 216.1.1 CPP)	Judges (article 216.1.4 CPP)	Prosecutors (Article 216.1.5 CPP)	Category A Civil Servants (Article 216.1.2 CPP)	SOE Managers (Article 216.1.8 CPP)	Others
Number of reports disseminated						
Aggregated value of suspected money laundering						

Statement by Oleksandr Petryk, Alternate Executive Director for Ukraine
September 14, 2016

After the sharp recession in 2014 and the first half of 2015, the economy has started to recover. Despite some signs of de-escalation, the geopolitical conflict in the East of Ukraine continues to hold back the pace of the recovery, creating uncertainty for investors and markets. Political tensions in late 2015 led to the appointment of a new government in April 2016. Regardless of this challenging environment, the authorities implemented difficult measures aimed at strengthening the fundamentals of the economy, restoring sustainable growth and financial stability. The authorities strive to achieve price and financial stability under the flexible exchange rate, establish a prudent, strong banking system, sound public finances, fight corruption, and implement comprehensive structural reforms in the public sector and state-owned enterprises.

Despite some delays due to the challenging environment and political uncertainty, all performance criteria and prior actions have been met, except for those on NIR for end-December 2015, the non-accumulation of external debt payment arrears, and the non-imposition of exchange restrictions. However, the progress on the program implementation has been impressive. Economic growth picked up, inflation has been drastically brought down, the banking system recovered, international reserves doubled relative to the beginning of the program, the 2016 fiscal deficit and the current account deficit are thus far in line with the program objectives, following a significant over-performance in 2015, and the debt operation with private bondholders has been completed. The authorities are committed to reach an agreement on the broader sovereign debt restructuring as soon as possible, in good faith and in line with the agreed program objectives.

The authorities remain strongly committed to continue with the program implementation and are determined to fulfill all obligations under the program, in order to achieve the program's long-term goals. The authorities are well aware of the risks and challenges ahead, and of the importance of a comprehensive approach and timely implementation of the reform agenda.

The Ex-Post Evaluation of Exceptional Access Under the 2014 SBA provides a useful assessment of the 2014 SBA. The authorities share the main findings of the report that, although the focus of the program was rightly on the immediate and medium-term objectives and important steps were taken under the program, the intensification of the conflict in the East and the loss of confidence led to unattainable program goals. Although the SBA clearly served as an anchor for the economic reform program in very difficult economic and political times, the replacement with an EFF allowed for more financing for a longer period, to support the authorities' deeper reform plans.

Macroeconomic outlook

The authorities broadly share staff's analysis of the economic outlook. In Q1 2016, for the first time since the Q4 2013, real GDP increased in annual terms and is projected to grow by 1.5 percent in 2016. However, this is somewhat weaker than expected, predominantly due to worse performance in selective service sectors. Industrial production also recovered more slowly than expected (by 1.7 percent in the first seven months of 2016 compared to the same period last year), because of difficulties in the mining and steel industries. Foreign trade is currently the main driver of economic growth, despite the intensification of restrictions in trade with Russia. Domestic investment increased in the first half of 2016 while private consumption remained subdued. Labor market conditions have started to improve with recovering real wages but unemployment remained high at around 10 percent. Inflation slowed to 8.4 percent in August 2016 due to moderate aggregated demand, prudent monetary policy, stabilization of the foreign exchange market and ample supply of food products. The current account balance improved noticeably due to the climbing grain export and higher-than-expected commodity prices. For some time, import remained in line with the program assumptions. In sum, the current account returned to a surplus in Q2 2016 of around US$1.0 bln. and remains in line with the program. International reserves increased to US$14.1 bln. in August 2016, almost double the amount of end of 2014.

Fiscal policy, tax and pension reforms

The government budget performed well in 2015 and 2016, as the authorities controlled spending. Debt interest payments declined following the debt restructuring. Revenues increased. Fiscal targets were met with large margins. The authorities are determined to further reduce the fiscal deficit to ensure debt sustainability, which is critical for financial stability. The parliament approved the 2016 budget in line with the program, supported by a new tax code as agreed with staff as a prior action. Parliament adopted a comprehensive package of tax policy reforms as required under a prior action for this review. A new electronic system of government procurement makes procedures more transparent and efficient, and public investment and services less expensive. Significant progress has been made with improving the tax and customs administration.

Pension reform is the cornerstone of the structural reform agenda, and critical for fiscal sustainability. The population is rapidly aging and the pension fund has a structural deficit that needs to be addressed. The authorities started with the reform agenda by eliminating special pensions to privileged groups. They also extended withholding pension for people that continue to work after reaching the retirement age and reduced the number of people eligible for early retirement (based on their occupation) by at least 40 percent (a prior action). As a new structural benchmark, the authorities will further reform the pension system and social security contribution.

Monetary and exchange rate policy and financial stability

In June 2015, the parliament amended the NBU law, thereby increasing the NBU's institutional and financial independence and allowing for implementation of policies to secure monetary and financial stability, reduce inflation and build up reserves. The flexible exchange rate helps adjusting to domestic and foreign shocks. The NBU intends to continue with foreign exchange auctions to further increase its reserves. The NBU has built up reserves of around US$3 bl. on a net basis since the end of February of 2015. The NBU also agreed on temporary swap/credit lines with the Riksbank and National Bank of Poland equivalent to US$1.5 bln.

The NBU, together with the IMF, developed a road map for further gradual and controlled removal of the administrative restrictions. The optimal strategy, which is a trade-off between the control of foreign currency outflow to ensure financial stability and the negative effects of the administrative restrictions, will be further developed. Strengthened communication with market participants is key to anchor expectations.

A strategy is implemented to adopt best practices of inflation targeting. The NBU board explicitly defined and announced the path of disinflation to reach in the medium term an inflation target of 5 percent associated with price stability. Last year, the NBU has set up a decision-making system based on a regular macroeconomic forecast, switched to a new operational framework with key policy rate as main instrument, and launched regular and systemic communications aimed at anchoring the inflationary expectations. Inflation is now an indicative target of the program. The authorities propose, on the occasion of the next review, the inflation as an indicative target of the program. For the next review, the authorities propose switching to inflation-based conditionality under the EFF program.

The monetary policy transmission mechanism will be gradually improved by narrowing the interest rate corridor and by ensuring that interbank rates remain close to the targeted policy rate. In addition, the NBU keeps the policy interest rate in the positive territory and stands ready to absorb excess liquidity if necessary.

Another key objective of the reform program is the sound and effective functioning of the banking system. The NBU made important progress with the rehabilitation of the banking system. Confidence was restored. The second stage of the diagnostics for the 20 largest banks was completed and recapitalization plans were submitted by the 16 banks which require additional capital. The NBU is currently monitoring the implementation of 14 plans. Capital requirements were increased and non-viable banks have been resolved. New legislation was introduced to limit lending to related parties and ensure transparent ownership of the banks. The Related Parties Monitoring Office (RPMO) has been staffed to monitor outstanding loans to related parties and reports regularly to the NBU Board. To solve the NPL problem, the authorities are working on strengthening the legal framework for private debt restructuring, adopting an out-of-court restructuring arrangement for corporate debt, and sponsoring a voluntary approach for the foreign currency denominated mortgage loans restructuring.

Banking regulation and supervision have significantly improved, in particular by conducting more risk-based supervision and new regulation on credit-risk activities. The NBU has started to work with a Registry of Borrowers which allows monitoring credit risks and related-party loans. Since December 2015, the NBU introduced monthly reports on potential problem banks, based on a revised Early Warning System (EWS). The Ministry of Finance, as the main shareholder of the state banks, made the commitment to run these banks on a commercial basis. The authorities have developed the Principles of State Banking Sector Strategic Reforms which provide a framework for transparency, improvement in management and a sound financial position of these institutions.

Structural reforms and anticorruption program implementation

The authorities made significant progress with reforming the energy sector. In particular, Naftogaz's finances were improved and its cumulative cash deficit reached 0.9 percent of GDP in 2015, which is better than the program target. The authorities remain committed to eliminate Naftogaz's deficit by end-2017. The retail gas tariffs were unified at the full-cost recovery level since May 1, 2016, as were the heating tariffs since July 1, 2016 (a prior action).

The authorities are implementing the anticorruption and judicial reform agenda. The National Anti-Corruption Bureau of Ukraine (NABU) finalized the recruitment process for competent staff and has started to operate. The management of the NABU is implementing the action plan, which was prepared by and agreed upon with foreign specialists, and supported by donors. The authorities have also established a specialized anticorruption prosecution function. The head of the anticorruption prosecutors and two deputies have been appointed in a transparent procedure (a prior action). The parliament adopted a law which requires that high-level officials will report their assets and income in an electronic declaration system. This information will also be publicly available online. Administrative reforms were launched with the traffic police, and many other public services and institutions underwent a clean-up procedure. The Ministry of Finance is implementing a framework for AML reporting and the NBU introduced risk-based off-site and on-site AML supervisory tools. The political influence in the judicial process remains a challenge. To address this problem, the parliament proposed amendments to the Judges' Organization. The preliminary draft was supported by the Venice Commission. These amendments will enhance the judicial independence, introduce standards and procedures for recruitment, and strengthen the management of the judiciary. Public administration reform has reduced the size of state working places. The reform in the civil service will reduce the wage bill and the size of the public administration thereby enabling higher wage levels to attract higher quality staff and reduce corruption.

The authorities continue with the reform of the state-owned enterprises. A privatization schedule for the 10 biggest SOEs was adopted. The government has initiated a review of the existing portfolio of SOEs to identify the non-operating ones for subsequent liquidation.

Final remarks

Despite the external and internal challenges, the Ukrainian authorities remain committed to continue with the difficult but necessary reforms. The new government is determined to reform the economy and lay the foundation for sustainable growth and prosperity of the country. There is broad support and agreement that this is the only way forward. The authorities are grateful for the cooperation with and support from the Fund, other IFIs and the international community.