

**Transcript of the press conference on the IMF's Stand-By Arrangement  
with Ukraine**

with **Jerome Vacher**, IMF Resident Representative in Ukraine  
Ukraine Crisis Media Center, Kyiv

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Mr. Vacher: Good morning. Thank you for coming and thank you to the Ukraine Media Crisis Center for such an efficient platform and forum.

This is an opportunity for me to brief you and take stock of basically where we are and what are the IMF's next steps in our cooperation with Ukraine. As you know the IMF's Executive Board had a meeting just a week ago, which approved a 2-year Stand By Arrangement for Ukraine in the amount of about US\$17 billion. Following the Board meeting, I'm taking this opportunity today to brief you.

We have published a significant amount of resources on our web site that you might find useful. That includes the staff report for the request for the program, which also includes all the relevant documents which have been discussed at the Board. That includes also what we call an IMF survey, which is an article on Ukraine, a blog posting on Ukraine as well, called Stabilizing Ukraine, and I would like also to draw your attention to the fact that we also have published material in Ukrainian on our resident representative in the Ukraine web site. There will be also an opportunity for further questions.

Tomorrow we shall have our regular press briefing in Washington. This is also another occasion for the media to ask questions on Ukraine. In the material that we have been publishing, you will find in particular an assessment of the economic situation and the challenges that were faced by Ukraine at the beginning of this year. The situation that we saw, and the challenges that we saw, in particular during the mission that the IMF had in March, included significant imbalances which have been known for a long time. That includes large current account deficit which reached over 9 percent of GDP, a large fiscal deficit, low growth and foreign reserves and a very difficult business environment. Faced with this difficult situation, the new government has taken decisive steps and we have been able to receive an excellent cooperation from the new authorities. That, in particular, has allowed us to proceed quickly with the design of a program of reforms which we prepared with the authorities.

So that program of reforms basically has five key areas. One, we noticed that the

authorities have engaged in a flexible exchange rate regime, which is a policy that the IMF has long been supporting. So the first key policy is basically to maintain that flexible exchange rate to ensure the competitiveness of the economy and support growth. Of course, this goes with a second aspect of the key set of policies that we have been discussing. That includes financial sector reforms- and this second set is an important set in our discussion and in the program of reforms in the government. This is basically designed to maintain confidence in the financial system and to strengthen over time the infrastructure for financial regulation and supervision. This is an important task, and the National Bank of Ukraine in particular has taken some first decisive steps. This will include the comprehensive assessment of the situation in the banking sector, but also, an important revamp of financial sector supervision and financial sector regulation. And again, this is important in the context of the flexible exchange rate regime.

The third key area of discussions and policy reforms that we discussed with the authorities are basically in the fiscal field. And here, the objective was basically to meet near term fiscal obligations and gradually reduce the fiscal deficit. The situation was difficult. There was a budget for 2014 which had been passed at the beginning of the year. If this budget had been still in place, combined with the deficit of Naftogaz, we would probably have a deficit of over 12 percent of GDP at the end of this year, so there was a need for decisive action. At the same time we were very mindful to take into account the potential impact on the economy and to design basically a gradual adjustment -- a decisive but gradual adjustment.

With this in mind, the authorities have put in place a package of measures that they have been designing, very much focused on expenditures, but here again, mindful of the impact on the economy and society, that includes a moderation in wage and pensions and basically not putting in place the unsustainable increases which had been decided in the previous budget. That also includes measures on the tax side, on the revenue side, so it is a broad package of fiscal adjustment.

Now fiscal adjustment cannot go without achieving a more self-sustained energy sector. As you may know in the company Naftogaz, there are large quasi fiscal losses. These losses are significant and need to be addressed. This has been a long standing issue. And it needs comprehensive solutions. What has been recommended and what the government has put in place is a gradual and decisive increase in gas and heating tariffs, which has long been needed. It has been needed for several reasons. One is of course the fiscal aspect, in the sense that gas and energy tariffs are well below cost recovery. They are also way below the level of neighboring countries. There are also issues of transparency in Naftogaz that needed to be addressed. There is also an overall issue of significant energy consumption in Ukraine. So all these issues need to be addressed. That being

said, we were conscious and the government is conscious that cost recovery cannot be achieved overnight, so a gradual increase was designed and at the same time, and this is an important component, there was an increase in social assistance schemes to protect the most vulnerable in society. The government has taken already some decisions on this and with the idea basically to protect the 30 percent most vulnerable in society.

Finally, and it's a related issue, the problem is also in another key area basically to improve transparency in the business environment. Of course, here again, nothing can be done overnight, but the idea is to kick start the reforms and to address the key elements that impede greater transparency and an improved business environment. So here we have discussed measures to improve transparency in Naftogaz, but also measures to improve public procurement- which has also a fiscal impact- to improve the situation with VAT refunds and generally speaking, measures that can improve the business environment.

Now a few words to summarize and to give you a sense of our current assessment. We believe we have a strong program which is addressing long standing economic problems. Thanks to the good cooperation that we had with the government and the Central Bank, we were able to design a road map and path to growth but the program is also designed to put in place the adequate safeguards. Of course when you are driving through this difficult road, you need to keep your hands on the wheel. You can look on the side on what is happening, on your back also what is happening, but the important thing is to keep your eyes on the road. We have a comprehensive set of prior actions which were taken. There were 12 prior actions which were taken as part of the program before the board approval. And we believe this has put the macroeconomic adjustment that we have been discussing firmly on course.

The available data so far, are in line or even sometimes better than projected in what we have in our macroeconomic framework. This is of course a tentative assessment - with some of the numbers for example on GDP for the first quarter point to that direction. However we have been very conservative in our estimates and in our forecast. Of course the economy and the program are also subject to a number of risks which I think are candidly described in the report. You know the situation is fluid in many ways. We are closely monitoring the situation and both the government and us are ready to take action and safeguard the program objectives.

Now some final words on the next steps on our side. Our support doesn't stop with financing. As you may know we are disbursing a first tranche this week. It has been disbursed. But in the next two months, we will provide a lot of support

and technical support to the authorities in implementing this program. We currently have a technical assistance mission on expenditure rationalization, advising the government on expenditure policies. We will soon have a team coming to prepare a diagnostic study on governance issues. We will have more fiscal technical assistance also within these next two months. And in preparation for the first review of the program, we will most likely have a mission -- a review mission coming at the end of June, beginning of July. We will give you an exact timing in due time once the dates are confirmed. In the meantime of course, the government and the central bank have a lot of work on their plate, but we are ready to support that strong commitment that we have seen in the last few weeks. Now I'm ready to take your questions.

QUESTIONER: Forgive me if I'm asking a question that's already in the literature that I haven't been over yet, but could you tell me if -- the subsidies that the eastern parts -- industries of the country have received in previous state budgets -- is that something that you addressed or looked at when considering this loan package?

Mr. Vacher: In our discussion with the authorities we basically recommended to them to take a package of measures, the design of which is largely left to the authorities themselves. They made us some proposals. But there was no consideration of specific measures with a regional dimension.

QUESTIONER: I'm an economic expert from America. Last week there was a round table discussion talking about weaning themselves from Russian oil. One of the four proposals consisted of whether there are plans to reduce energy by about a third. I favor that plan and during that discussion, I suggested that some of the funds from the IMF and other donors, be set aside into an insurance pool, thereby creating a loan guarantee fund, creating an infrastructure bank, combine that with city funds in the east and throughout Ukraine, and use that money to focus on decentralization, community reinvestment banking because housing is down, and that would create three to five million jobs in Ukraine. Would you be willing to discuss with Groysman's Deputy Assistant, the other people that were here last week discussing that, to try to create that insurance pool loan guarantee which would leverage the IMF funds many times over?

Mr. Vacher: Of course we will monitor closely the developments and the future reforms related to fiscal decentralization. What I -- what basically we have been discussing with the authorities and what is reflected in the program, which is basically a comprehensive energy sector reform which in particular aims at reducing quasi fiscal losses, also at reducing energy consumption in Ukraine, and this is of course accompanied by a number of further measures that some, for

example, other international financial institutions can support, and that includes measures on energy efficiency for example, and which are highly needed but which take a long time to be put in place. So, this is the idea of the energy sector reform. At the time of the discussions on the stand by arrangement, there was no specific plan for fiscal decentralization, no finalized plan at the time, so that didn't enter into the equation, but that being said, as I mentioned we are monitoring this closely.

QUESTIONER: Actually my question, the first one is could you please give yes or no on whether IMF funds could be used by Ukraine to repay August bond bills. And the second question is, there are some who thought that the next transfers of IMF help will be somehow tied to the question whether you are paying central government can recess control over eastern regions. Could you please tell me, is it true, or no? Thanks.

Mr. Vacher: On your first question, the way we have designed the program and the financing package, basically allows the Ukrainian government to repay its arrears and also stay current on its obligations, on its current obligations basically. So that's how the program was designed. And it's reflected basically in the financing package. Now on your second question, we are of course monitoring the situation closely. What we look at of course is we look at primarily at the numbers and the policies. This is our task. As I mentioned earlier the situation is very fluid. We monitor it closely. We'll have several opportunities to assess the economic outlook of course and as soon as the numbers can come in, but there is no definite timeline on this or any specific constraint on the side. As I said, we monitor the situation closely. We will look at the numbers when they need to be reassessed and we look at the economic outlook if there is any impact on the economic outlook that we have projected in particular. But there is no specific timeline. The situation is very uncertain and fluid.

QUESTIONER: (off mic)

Mr. Vacher: No, as I mentioned we basically try to monitor the situation closely with the authorities. They provide us some data to be able to do that. It is not the full situation on the ground, it is not always reflected in the data, so some of the feedback on this would -- and some of the questions on this would probably be better addressed to the authorities and the people who have a better feel of the situation on the ground. But we, as I mentioned earlier, we were aware of the risks at the time of the board discussion. I think, in the staff report in particular, we provide a candid assessment of the risks that we saw to both the economic outlook and the program.

Mr. Vacher: Another follow up question to that, sorry, if in the worst case scenario, if the east was to go the way of Crimea, or another sort of way in which it was somehow split off, would the loan package agreement have to be somehow redesigned?

Mr. Vacher: Well, first of all, let's try not to speculate on any of this. As I said, we will look at the numbers and how we see the economic outlook, the fiscal situation and the situation of financial sector to make our assessment. We will look also at the degree of effective control that is prevalent in the different areas. With this in mind again, we will look again candidly to the risk to the program and if there is a need to adjust our economic outlook in particular, we'll do that. So far we have no indications to that effect.

QUESTIONER: The IMF consists of the most powerful bankers in participating institutions in the world. Why would you all support paying fees to Russia based on the agreements that President Yanukovich and President Putin put together in December when Yanukovich was still president (inaudible) prices down to a normal market rate because Ukraine had paid above market rate for the past four years, thereby paying 14 billion too much. The US\$3.5 billion reduction each year down to normal market rate -- why doesn't the IMF use the most powerful bankers in the world, which also contribute large sums of FDI in Russia, to sue unto WTO's to maintain that price rate down to market rate of about 280 I think versus 500 per thousand cubic meters of gas?

Mr. Vacher: Just a few considerations to answer your question. One, the IMF is staffed by international civil servants, not bankers. Our board includes all our member countries, which are most of the countries in the world. So that's one thing, just to clarify, and I will be glad to provide any information that you need on the institution. Second, on matters related to gas, it is always difficult to pin down what is really a market price for gas, but as you know, those prices are determined by basically long term supply contracts which vary by countries. You can find an average of prices in the EU -of prices which are used in some of these countries - but it's difficult to pin down a real market price. What we have done in the context of the program, first as I said, is basically to provide sufficient room in terms of financing to clear arrears, and second, our assumption in the program for forecasting - because we have to forecast for over several years- has been using a price of 395 dollars. Now, the discussion and the negotiation on the price is a basic matter between Naftogaz and Gazprom.

QUESTIONER: But if you guys are the ones giving the money -- the IMF, then aren't you taking over or assuming the responsibility of Naftogaz's financial situation? Basically Naftogaz is in a default situation and the world community --

the world banks are coming together to fund that. So don't you have tremendous leverage power to put Ukraine in a better position, all the pensioners in a better position in Ukraine, create a long term contract with lower rates, thereby guaranteeing the funding to Russia, also guaranteeing better (inaudible) as a whole and putting the IMF in a position of stability?

Mr. Vacher: I can tell you what our approach has been. Basically we have been advising the authorities and providing recommendations on how to reestablish the financial soundness of Naftogaz over time. That includes a set of measures as I mentioned. That includes gas tariff increases, but that also include some other measures and reforms in the energy sector, including on things like energy efficiency for example. So it's a broad agenda of reforms. And on our side we are basically advising and recommending policies to the authorities to address the imbalances that we have talked about before -- address it in a sustainable way and also address this in a manner that is mindful of impact on the population basically. That is why there has been an increase in social assistance to the most vulnerable. This is a key consideration in the design of this program. The IMF -- is an international institution. We do not take over commercial enterprises. So this is a responsibility of the shareholder of these enterprises -- basically the Ukrainian government.

MODERATOR: Do we have any other questions? Then we thank you very much for your time and coming today. Thank you.

Mr. Vacher: Thank you very much.