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IMF Announces Staff Level Agreement with Ukraine on First Review under the Stand-By Arrangement

An International Monetary Fund (IMF) mission visited Kyiv during June 24-July 17, to hold discussions on the first review under the Stand-By Arrangement (SBA) in support of the authorities' economic reform program. At the conclusion of the visit, Mr. Nikolay Gueorguiev, mission chief for Ukraine, made the following statement today in Kyiv:

"The mission has reached understandings with the Ukrainian authorities on the policies necessary for the completion of the first review under the SBA (see Press Release No. 14/189). In this regard, the authorities have committed to take a number of policy actions prior to the completion of the review. As is usual practice, the understandings reached with the authorities are subject to approval by IMF management while the completion of the review is subject to approval by the Executive Board. The completion of the review would enable the disbursement of SDR 914.67 million (about US$1.4 billion).

"The mission found that policies have generally been implemented as planned and that all but one of the performance criteria for end-May have been met. All structural benchmarks for the first review have been met as well, although some of them with a delay. This is a notable achievement as the intensification of the conflict in the East means that the program has been implemented in an environment that is considerably more difficult than anticipated when it was launched.

"The conflict is putting increasing strain on the program and a number of key elements of the macroeconomic framework have had to be revised: (i) economic prospects have deteriorated notably, and GDP is now expected to contract by 6.5 percent this year, compared to 5 percent when the program was adopted; (ii) a shortfall in revenue collections in the East, higher security spending, and lower-than-expected debt collection by Naftogaz will cause fiscal and quasi-fiscal deficits and financing needs to rise above the programmed path; and (iii) higher-than-expected capital outflows and monetization of fiscal deficits are causing pressures on net international reserves.

"Notwithstanding the authorities' continued commitment to the program and good record of implementation so far, the authorities have decided to take a number of compensatory measures to limit the negative impact of the conflict in the short run, and ensure that key program objectives are achieved over the period of the two-year program:

- On fiscal policy, the authorities have decided to implement a package of revenue and expenditure measures, amounting to 1 percent of GDP in 2014, offsetting the effect of increased security spending by other expenditure cuts. They have also committed to limiting wage and pension increases to the level of inflation in 2015, continuing reform-based reduction in public sector employment, and exercising tight control over discretionary spending.
- In the energy sector, the authorities are taking additional actions to strengthen payment discipline and compliance, such as pursuing payments from collectible accounts and seizing assets if repayment is not forthcoming. They are also preparing to restructure Naftogaz with a view to improve the transparency of its operations and reduce costs.
- In the area of monetary policy, the program will allow for a larger drawdown of net international reserves to prevent destabilizing exchange rate movements. But the National Bank of Ukraine (NBU) will limit the decline in reserves through some purchases from the market, and it has reiterated that it stand ready to achieve the revised path for net international reserves by allowing the Hryvnia to depreciate, if necessary. Meanwhile, the NBU will continue to upgrade its monetary policy framework with a focus on domestic price stability and prepare for inflation targeting. The operational framework and financial position of the Deposit Guarantee Fund are being enhanced as well to maintain confidence in its ability to execute its mandate.
- The authorities are taking steps toward strengthening governance and improving the business climate. A recent diagnostic study has identified major areas for reforms. Based on the study's recommendations the authorities plan to implement a wide range of anti-corruption measures, including establishment of an independent anti-corruption agency with broad investigative powers and adoption of legislative amendments to support the anti-corruption effort.

"On the strength of these compensatory measures and continued implementation of other policies agreed when the program was approved, staff is confident that the program can achieve its fundamental objectives of restoring internal and external macroeconomic equilibrium, generating sound and sustainable economic growth, and strengthening economic governance and transparency. In particular, while the combined fiscal and quasi fiscal deficits are projected to amount to 10.1 and 5.8 percent of GDP in 2014 and 2015, respectively—compared to previous targets of 8.5 and 6.1 percent—the structural adjustment is stronger by ½ percent of GDP over 2014-16 and the headline deficit will be below the originally programmed path by 2016. Similarly, gross reserves will be only some US$3.4 billion lower than programmed by end-2015. While external debt to GDP will peak 7 percentage points higher than programmed at end-2015, it will be on a steady downward slope by the end of the program, suggesting that external viability is not at risk.

“The program hinges crucially on the assumption that the conflict will begin to subside in the coming months. While the authorities’ determined implementation of the program so far, including the compensatory measures agreed in the context of the current review, augur well for their ability to continue to adjust the program as circumstances evolve, a significant prolongation of the crisis would seriously strain their ability to do so without a substantial increase in external support on adequate terms. Fund staff will remain in close consultation with the authorities and their international partners as the situation unfolds.”