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Ukraine: Economic situation and IMF support

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Economic outlook of Ukraine

1. Background: How did we get here?
2. An IMF supported reform program
3. Challenges and risks: going forward



Background: Years of unsustainable macroeconomic policies...

A largely inadequate policy mix in previous years:

- Large fiscal and quasi fiscal deficit
 - Absent any adjustment and based on budget adopted in Jan. 2014 combined deficit > 12 percent of GDP
- Fixed exchange rate
- Large current account deficit
- Low level of reserves



Background: Lack of structural reforms

- Growth well below potential since a tepid recovery from the 2008-2009 crisis
 - Pervasive corruption
 - Poor business environment
 - Lack of FDI
 - Productivity lags
- Lack of commitment on significant economic reforms



Strong commitment to new policies but impact of the conflict

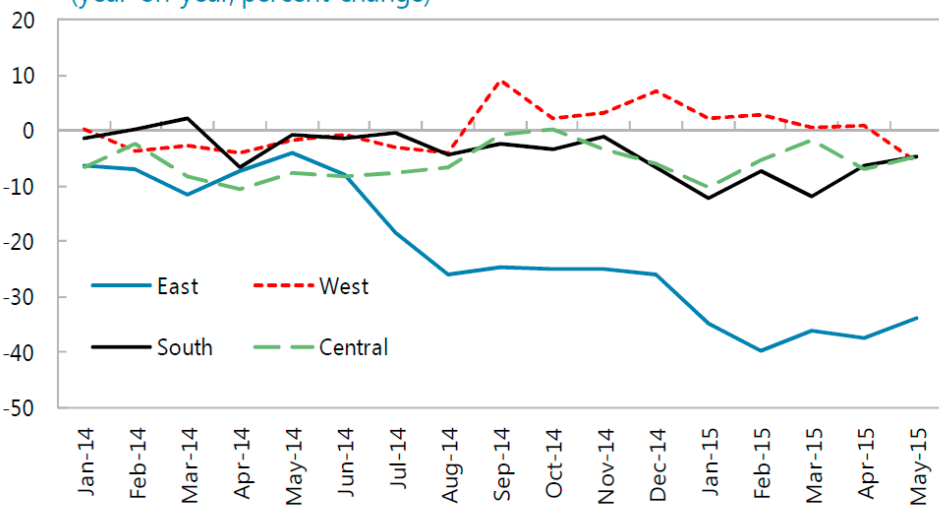
Impact of the conflict and its intensification in
the summer of 2014:

- Direct impact:
 - Real sector (industrial production, export, import)
 - Fiscal (revenues, expenditures)
 - Financial sector and demand for Fx
- Most important: impact on confidence
(domestic, external)

Direct impact

Industrial Production

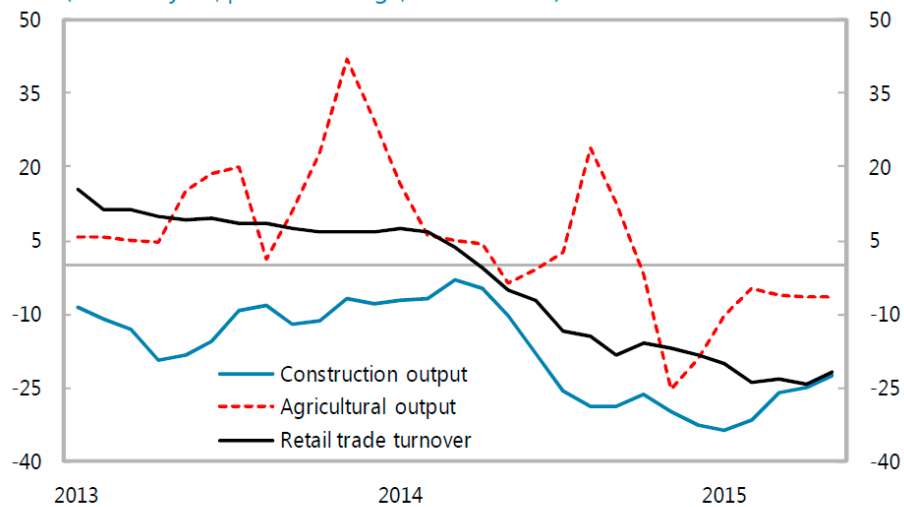
(year-on-year, percent change)



Source: State Statistics Service of Ukraine.

Agriculture, Construction and Retail Trade

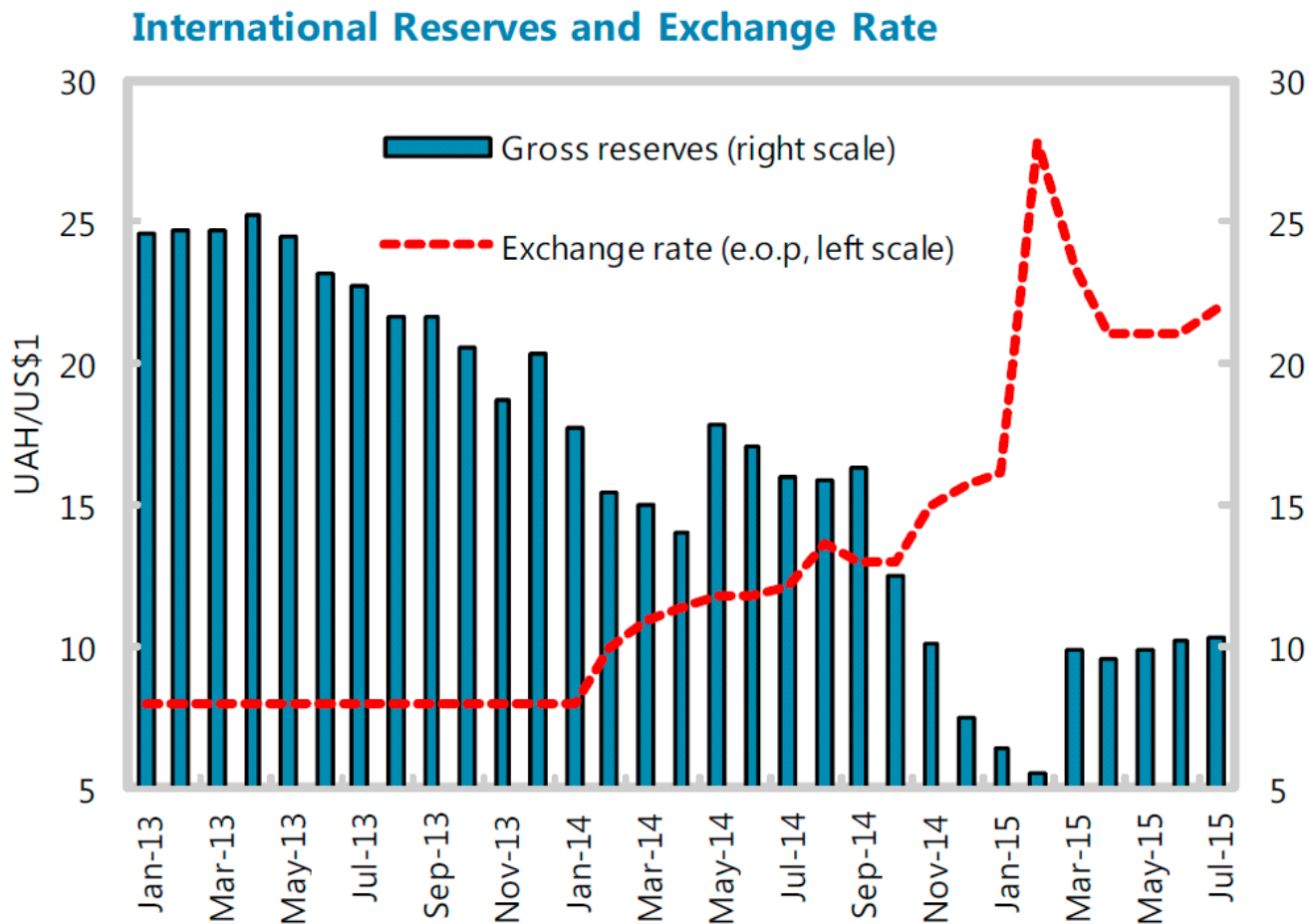
(Year-on-year, percent change, 3 month ma)



Source: State Statistics Service of Ukraine.



Gradual depletion of reserves reflected imbalances and the impact of the conflict





A new IMF supported program

Moving from a Stand By Arrangement to an Extended Fund Facility:

- 4 year arrangement (instead of 2 years)
- Longer repayment period
- Focus on structural reforms
- Frontloaded:
 - 1st tranche: 5 bn USD (of which 2.7 bn USD in budget support)
 - 2nd tranche: 1.7bn USD
 - Total expected for 2015: 10 bn USD



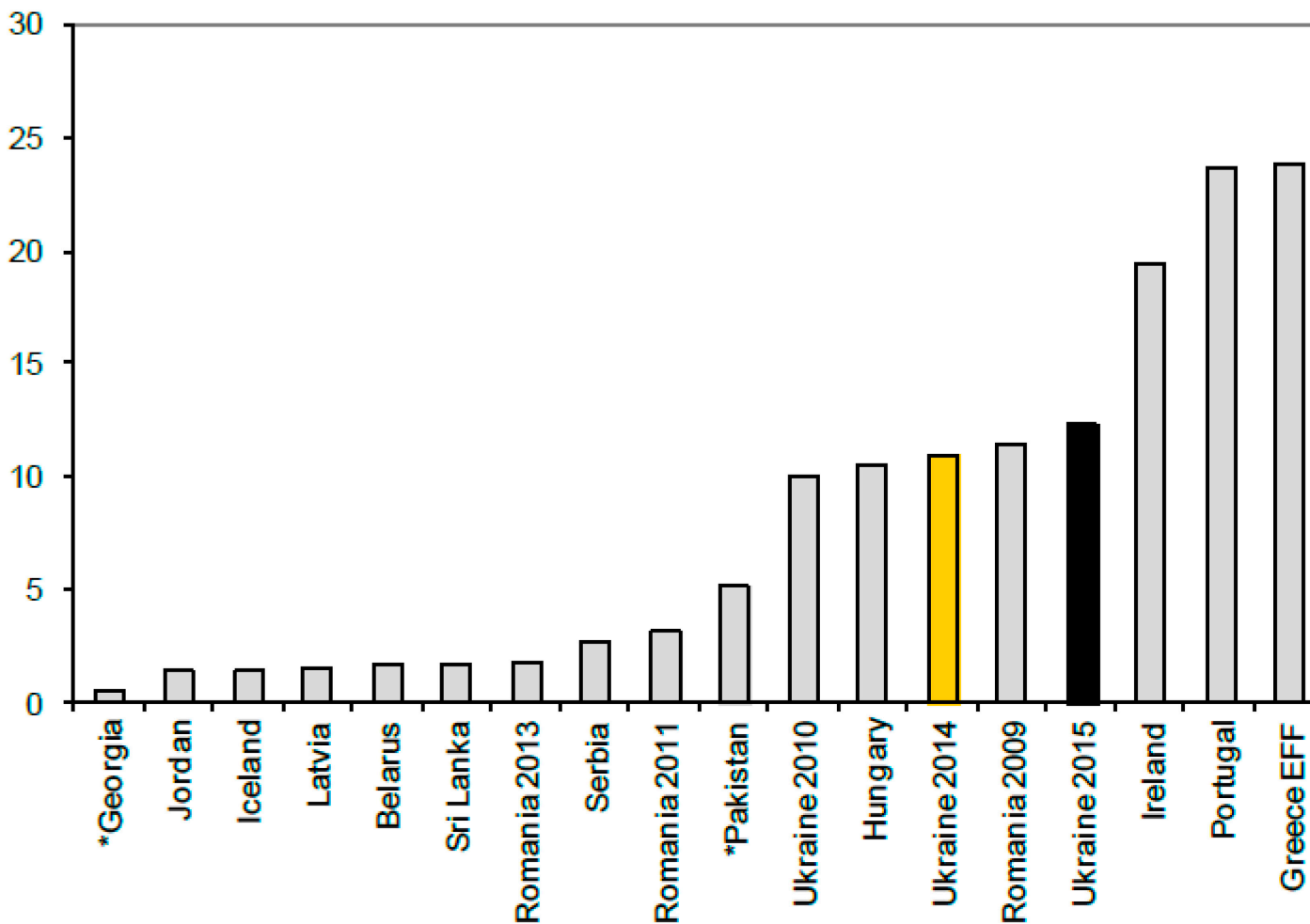
Exceptional access criteria

1. Exceptional BoP pressures
2. High probability that public debt is sustainable in the medium term
3. Prospects of gaining or regaining market access
4. Strong prospect of success of policy program (adjustment plans, institutional and political capacity)



Exceptional access in perspective

A. Total Access of Recent Exceptional Access Arrangements 1/
(In billions of SDRs)





IMF program part of a larger financing package

Ukraine: Program Financing (US\$ billion)

	2015	2016	2017	2018	Total
Financing Gap 1/	21.4	6.8	6.9	4.8	40.0
Reserve accumulation	10.8	3.9	6.3	6.7	27.7
Underlying BOP gap 1/	10.6	2.9	0.7	-1.9	12.3
Identified Financing 2/	21.4	6.8	6.9	4.8	40.0
Bilateral and multilateral	16.3	3.5	2.5	2.5	24.7
IMF	10.0	2.5	2.5	2.5	17.5
Other multilateral/bilateral	6.3	1.0	0.0	0.0	7.2
Multilateral	1.8	0.0	0.0	0.0	1.8
European Union	1.8	0.7	0.0	0.0	2.5
United States	2.0	0.0	0.0	0.0	2.0
Other bilateral	0.7	0.2	0.0	0.0	0.9
Debt operation	5.2	3.4	4.4	2.3	15.3
<u>Memorandum items:</u>					
Project loans 3/	2.0	2.6	2.7	2.2	9.5
Multilateral	2.0	2.2	2.4	1.8	8.4
Bilateral	0.0	0.4	0.4	0.4	1.1
Gross international reserves	18.3	22.3	28.5	35.2	
% of composite metric	66	79	96	113	

1/ Excludes the effect of spending reflected on the current account generated by project loans.

2/ Excludes project loans.

3/ Project financing to the public and private sector.



5 key areas

1. Exchange rate and monetary policies
2. Financial sector stabilization and reform
3. Fiscal adjustment
4. Energy sector reform
5. Structural reforms



Fx and monetary policies

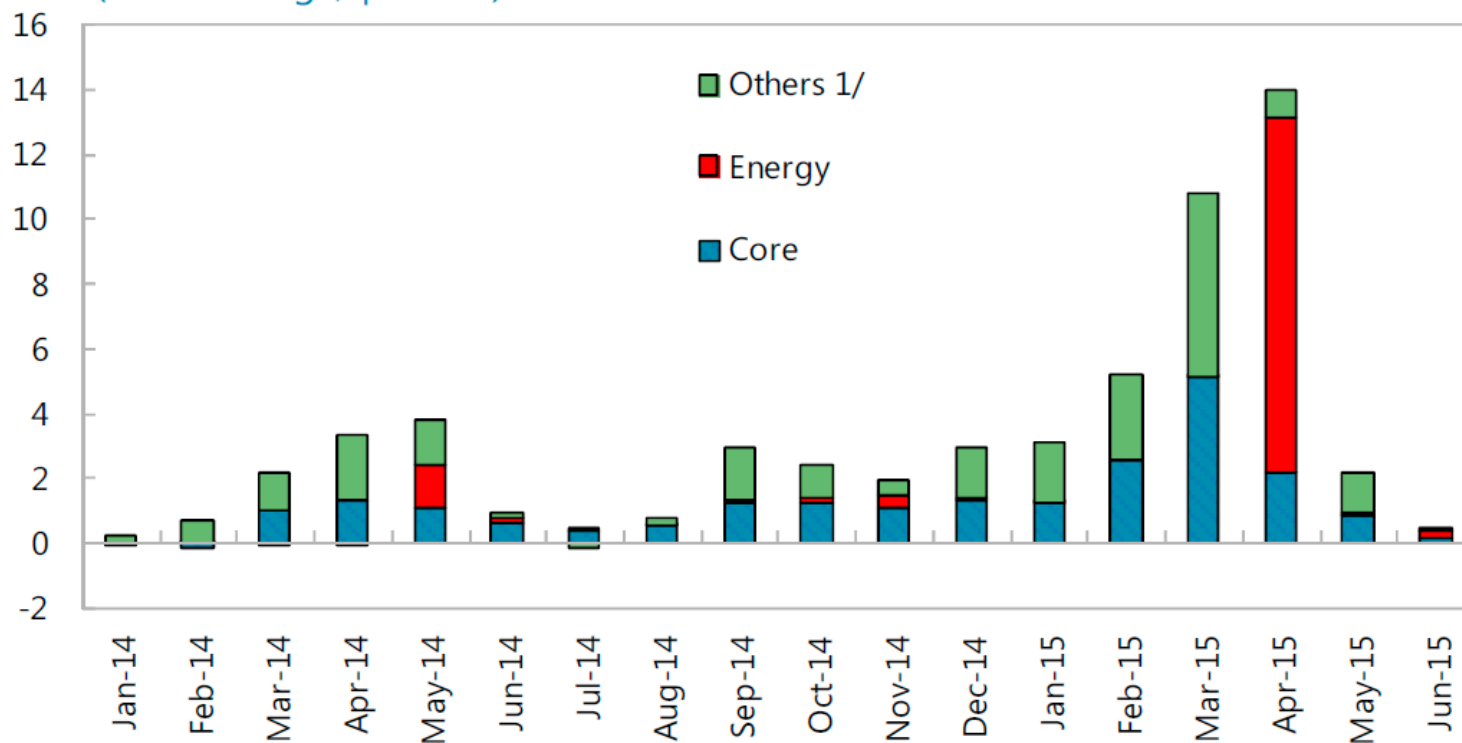
1. Maintain a flexible exchange rate to restore competitiveness and foster accumulation of reserves
2. Focus monetary policy on domestic price stability
3. Prepare to move to inflation targeting



Inflation rose sharply in March-April, as a result of pass-through factors and has declined since

Contributions to CPI

(MoM change, percent)



Source: National authorities and IMF staff calculations.

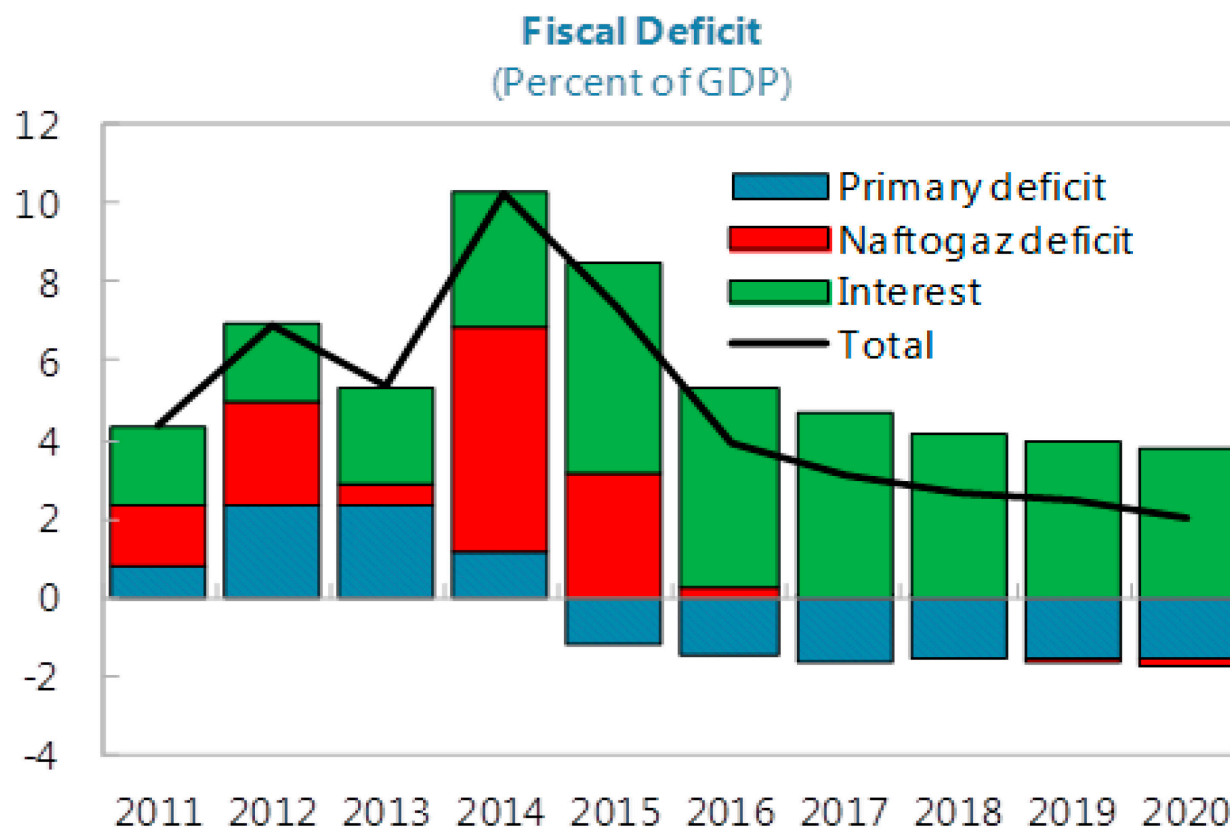
1/ Raw food, fuel and administrative prices other than energy.



Fiscal adjustment

- Enhanced revenues and collections
 - Elimination of fraudulent tax evasion schemes
 - Higher excises, Social Security Contribution reform
 - Closing of VAT loopholes, in particular in agriculture
 - Revenue administration reform
 - Pension reform

Fiscal adjustment



2011 2012 2013 2014 2015 2016 2017 2018 2019 2020
Sources: Ukrainian authorities and staff calculations.



Energy sector reform

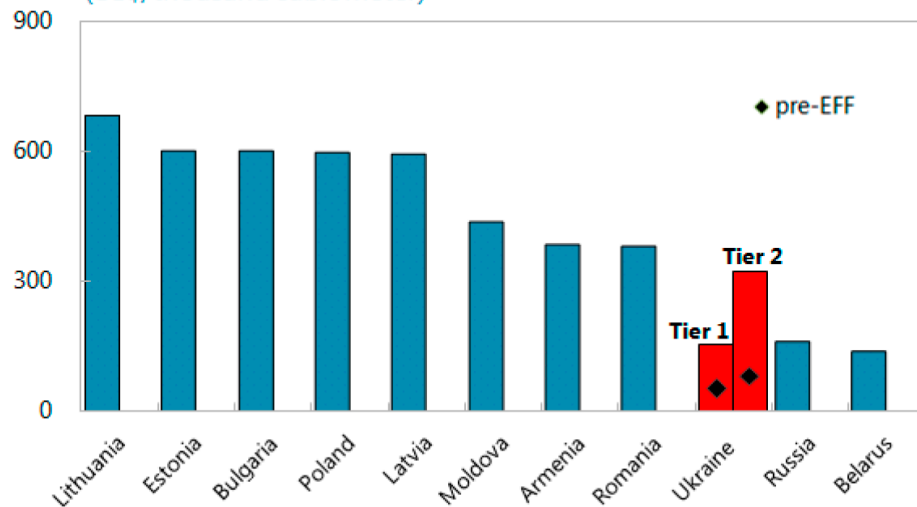
1. Increased gas and heating tariffs over time towards cost recovery
2. Accompanied by enhanced sustainable social assistance measures to mitigate the impact on the poorest (shift of subsidies directly to households that need it)
3. Improvements in governance and transparency
4. Strengthening of payment discipline



Energy tariff increase

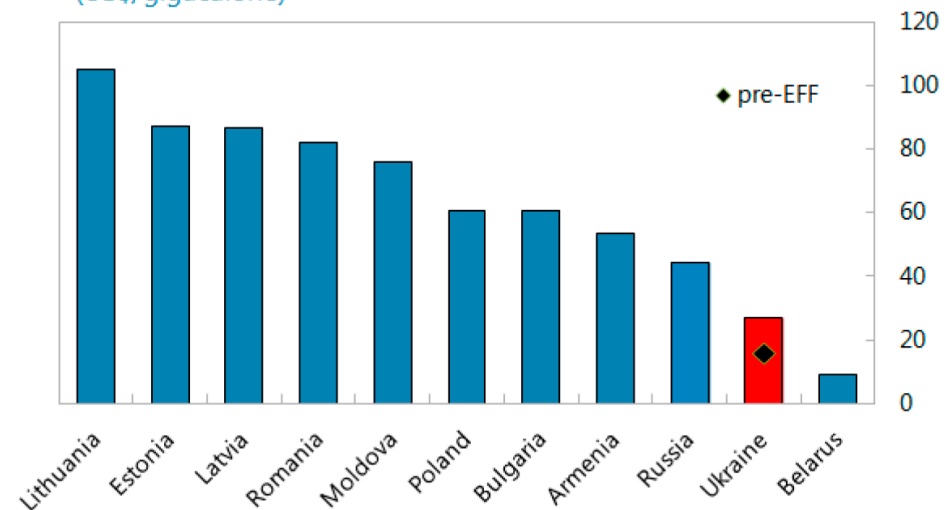
Natural Gas Tariffs in Select Transition Economies

(US\$/thousand cubic meter)



Heating Tariffs in Select Transition Economies

(US\$/gigacalorie)



Source: Ukrainian authorities; Eurostat; WB and IMF staff estimates; www.energy.eu; www.euroheat.org.



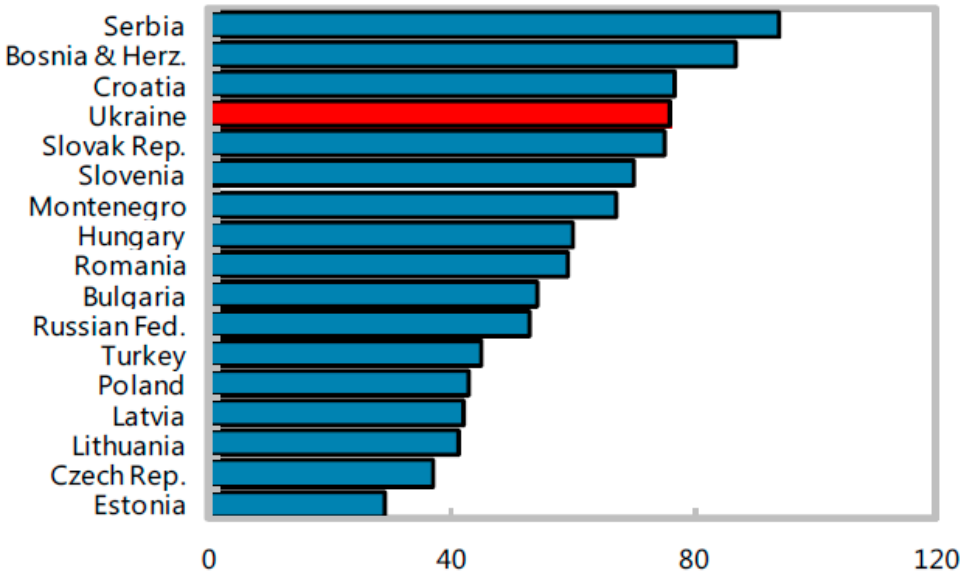
Governance and the business climate

- National Anti Corruption Bureau
- AML and asset disclosure
- Improvement of the business climate and deregulation
- Effectiveness of the judiciary
- Reform of state owned enterprises

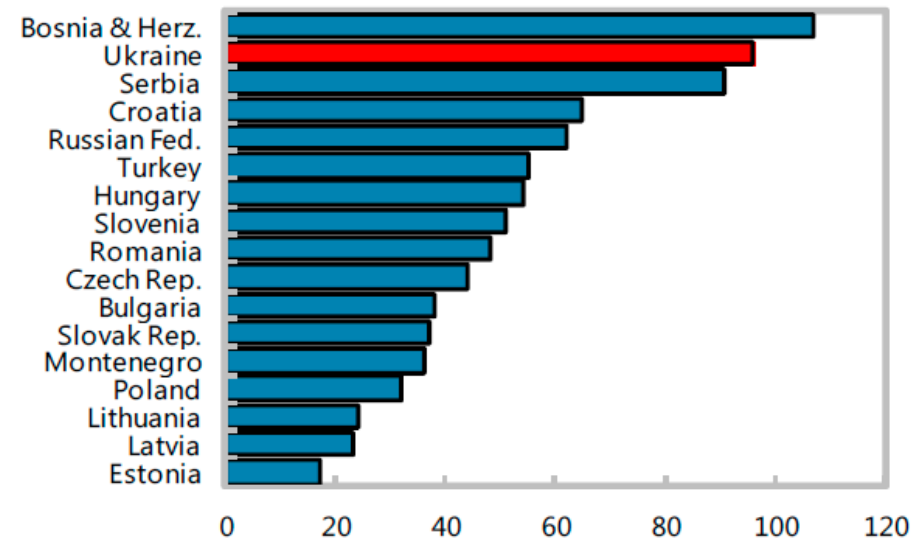


Low competitiveness and unfavorable business climate

Global Competitiveness ranks 2014-2015 3/



Ease of Doing Business 2015 3/



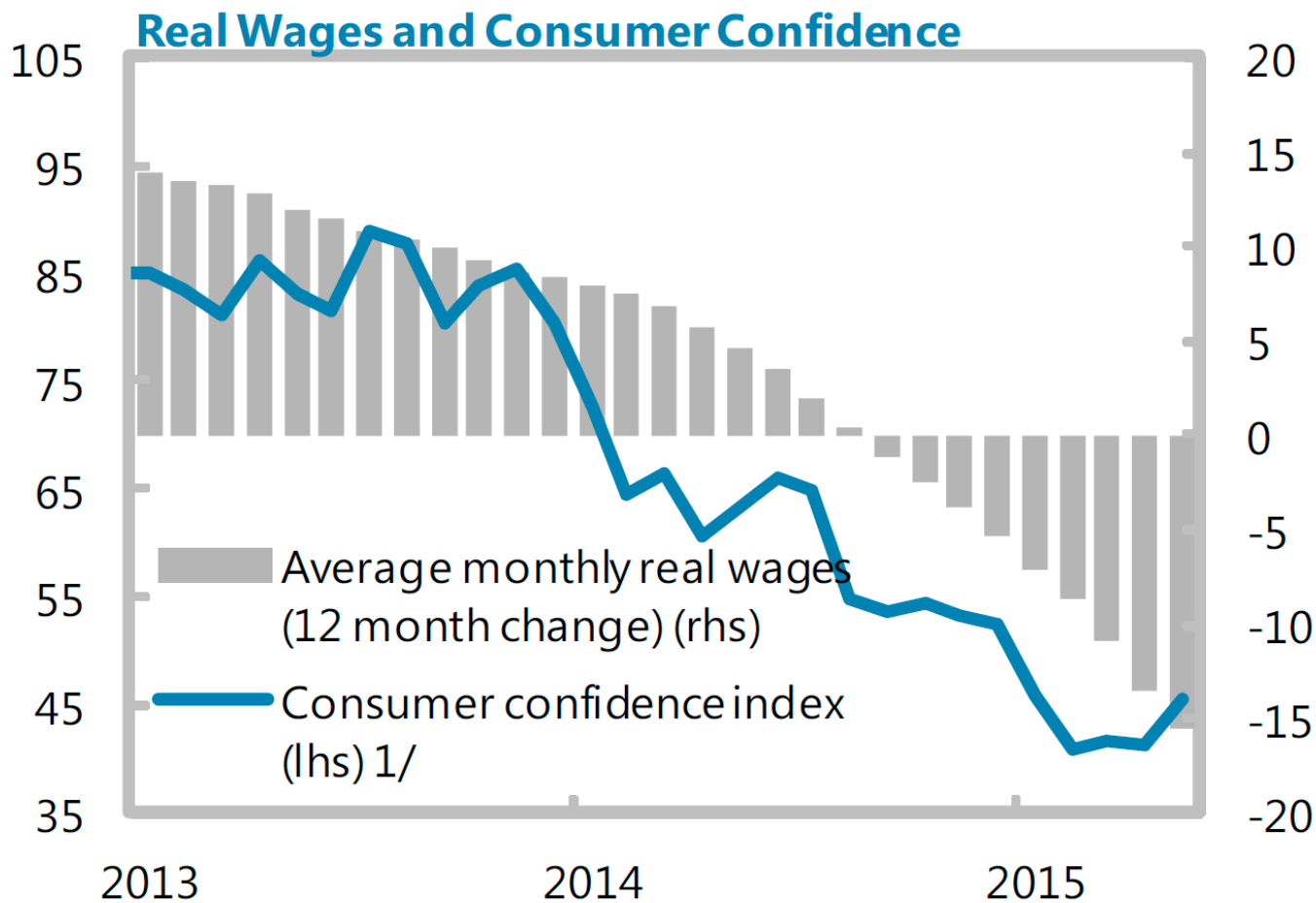


Ongoing developments

- Ongoing current account adjustment
- Episodes of exchange rate volatility and lack of confidence in the banking system
- Security developments continuing to drive market volatility
- Pressure on household incomes and corporate restructurings
- Tentative signs of stabilization: industrial production and real GDP bottoming out



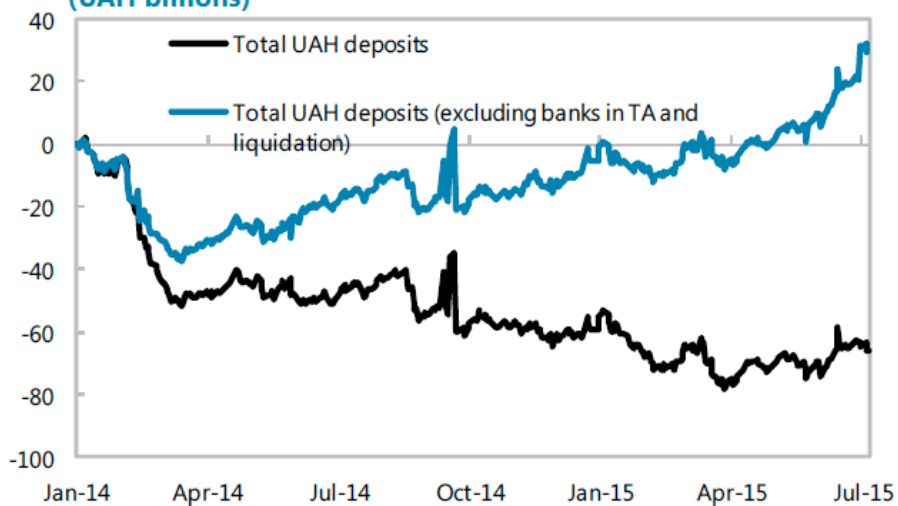
Real wages declined sharply, although consumer confidence has moderately rebounded



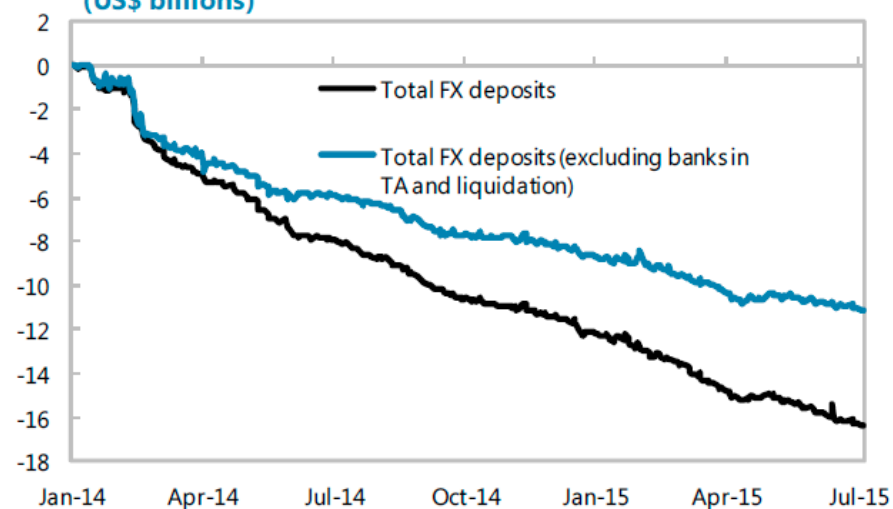


Hryvnia deposits are rising while the decline in FX deposits is slowing

Change in Banking System UAH Deposits, 2014–15 ^{1/}
(UAH billions)



Change in Banking System FX Deposits, 2014–15 ^{1/}
(US\$ billions)



Source: National authorities.

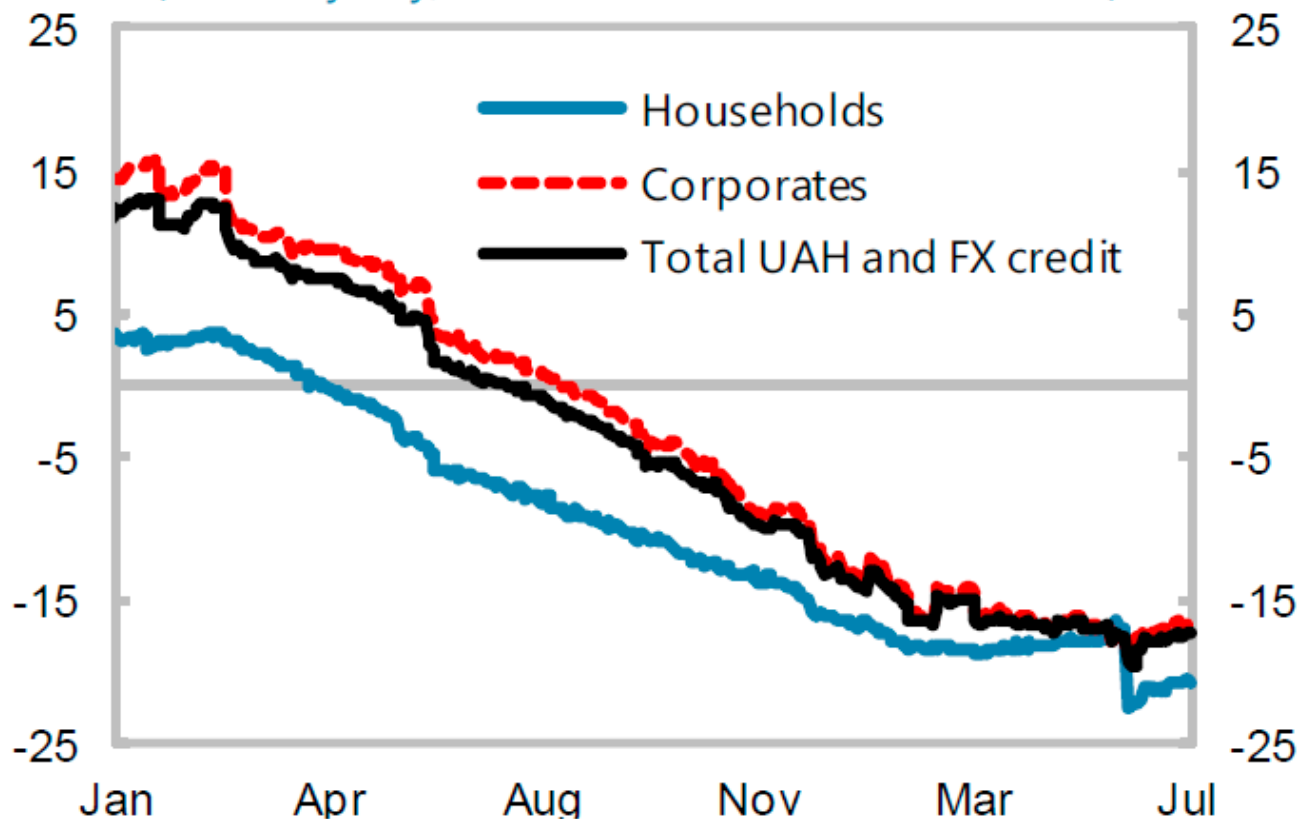
^{1/} Change since January 16, 2014.



Credit to households has stabilized at a lower level

Change in Banking System Credit, 2014-15

(Percent y-o-y, under fixed ER of 7.993 UAH/US\$)





An important milestone in debt operation has been reached

Agreement with the committee of creditors:

- Haircut of 20% on sovereign and guaranteed debt
- Interest rate slightly higher – 7.75% compared to the current 7.2%
- Maturity extensions
- Value recovery instruments



The agreement satisfies the three objectives for the debt operation set by the IMF

Three objectives for the debt operation

- Reduce annual post-program gross financing needs
- Place public debt on a downward path
- Provide targeted external debt service relief



However, risks remain on the downside

1. Extension or worsening in geopolitical tensions
 - Tensions in the East and relations with Russia
2. Financial sector risks
3. Program ownership, domestic politics and policy slippages
4. Financing



Conclusions

- A critical and challenging reform program for Ukraine: rebuilding confidence and institutions
- Commitment, program ownership and maintaining the reform momentum will continue to be key
- Support of reforms by the international community also fundamental
- Crisis should be used as a unique opportunity to reform
- Return to growth might be slower, important to show short term decisive gains (e.g. anti-corruption) and medium term path to the population.



**More information at
The IMF Resident Representative Office in Ukraine
Website**

<http://www.imf.org/external/country/UKR/rr/index.htm>

Thank you!