September 2009
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Ukraine: Second Review Under the Stand-By Arrangement and Request for Modification of Performance Criteria—Staff Report; Press Release on the Executive Board Discussion

In the context of Second Review Under the Stand-By Arrangement and Request for Modification of Performance Criteria, the following documents have been released and are included in this package:

- The staff report for Second Review Under the Stand-By Arrangement and Request for Modification of Performance Criteria, prepared by a staff team of the IMF, following discussions that ended on July 3, 2009, with the officials of Ukraine on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 23, 2009. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A Press Release summarizing the views of the Executive Board as expressed during its July 28, 2009 discussion of the staff report that completed the review.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

UKRAINE

Second Review Under the Stand-By Arrangement and Request for Modification of Performance Criteria

Prepared by the European Department in Consultation with Other Departments

Approved by Poul M. Thomsen and Lorenzo Giorgianni

July 23, 2009

Executive Summary

Stand-By Arrangement: A two-year SDR 11 billion SBA involving exceptional access (802 percent of quota) was approved by the Executive Board (Country Report No. 08/384) on November 5, 2008. A first purchase of SDR 3 billion was made following the Board meeting. A second purchase of SDR 1.9 billion was made following the completion of the first review on May 8, 2009. The program foresees a disbursement of SDR 2.1 billion following the completion of the second review.

Program status: Since the first review, policy implementation has been broadly in line with the program, and all end-May quantitative performance criteria were observed. However, the sharper economic contraction and the imbalances of Naftogaz' finances put additional stress on public finances. The deficit target has been increased to cushion the economic contraction and budget transfers to Naftogaz. To reduce fiscal risks and avoid crowding out of private sector activity, the authorities reduced non-priority expenditures, increased domestic gas prices, adopted a restructuring strategy for Naftogaz, and made progress in the preparation of structural reforms. The current monetary policy stance is broadly appropriate considering the potential build up of a large monetary overhang against the backdrop of subsiding inflation and exchange rate pressures. The central bank has amended recent regulations that limited progress towards a more flexible exchange rate policy. The authorities have made progress towards resolving systemic problem banks and will shortly enact legislative amendments for the effective resolution of nonsystemic insolvent banks.

Discussions were held in Kyiv during June 24-July 10. The mission met with President Yushchenko; Prime Minister Tymoshenko; NBU Governor Stelmakh; Minister of Economy Danylyshyn; Acting Minister of Finance Umanskiy; and the Presidential Administration. The mission also met with the Party of Regions and other senior representatives and officials. The staff team comprised Ms. Pazarbasioglu (head); Messrs. Hofman and Moulin, and Ms. Yang (all EUR), Mr. Arslanalp (FAD), Mr. Duenwald (SPR), and Mr. Olafsson (MCM). Mr. Alier (resident representative) assisted the mission.

Publication: The Ukrainian authorities intend to allow the publication of the staff report.

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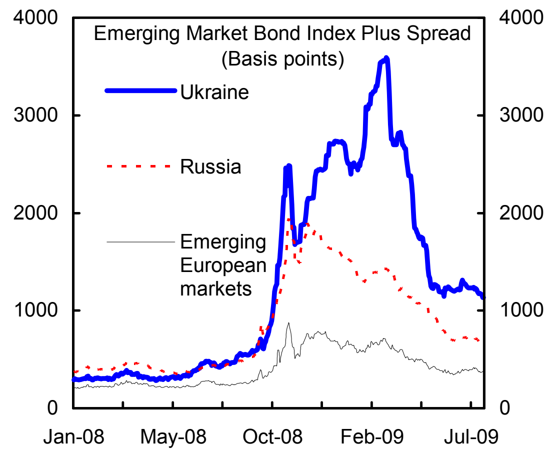
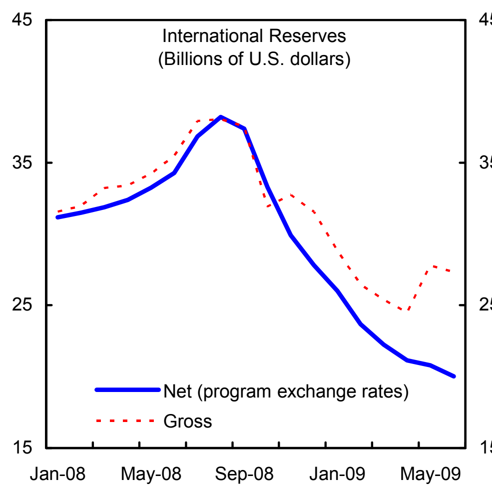
I. Introduction and Summary

1. **Financial stress has eased since the completion of the first review, but the economic downturn has been more pronounced than expected.** The global improvement in market sentiment has had a positive impact on Ukraine. Five-year CDS spreads are markedly down, the equity market has staged a pronounced recovery, external financing has continued to hold up better than expected, and pressures on the exchange rate have declined. Another encouraging sign is the stabilization of bank deposits, which signals some return of confidence. However, as in other countries of the region, the recession in Ukraine has turned out to be sharper than initially envisaged with real GDP now expected to contract by 14 percent in 2009, against 8 percent at the time of the first review.



Source: Bloomberg.



Sources: NBU; and IMF staff estimates.

2. **Policy implementation has been broadly in line with the program.** The end-May quantitative performance criteria on base money, NIR, and the general government balance were met. The authorities made progress in the resolution of the systemic problem banks and in preparing associated legislative actions. The government has strengthened its efforts to develop domestic sources of financing, including by accepting market rates in its treasury bills auctions. However, the fiscal balances have continued to deteriorate and resolute action is needed to contain the situation. Also, while steps have been taken toward greater exchange rate flexibility, the hryvnia has in practice fluctuated within a narrow margin, reflecting increasing confidence but also administrative controls and moral suasion. Import surcharges, imposed prior to the first review, remain in place.

3. **Policies under the program continue to be adapted to changing circumstances:**

- The definition of the fiscal deficit has been broadened to cover Naftogaz, and the target for 2009 has been adjusted to cushion the economic contraction. The new deficit target (excluding bank restructuring costs) is set at 8.6 percent of GDP—6 percent of GDP for the general government (4 percent in the first review) and 2.6 percent of GDP for Naftogaz. To preserve fiscal sustainability, the authorities

- have introduced 0.6 percent of GDP in measures (1.4 percent annualized), announced a schedule of natural gas price increases, renewed their commitment to structural reforms, and agreed to contain the 2010 deficit (including transfers to Naftogaz) to 4 percent of GDP. They have started taking actions to strengthen the financial situation, transparency and governance of Naftogaz, according to a strict timetable.

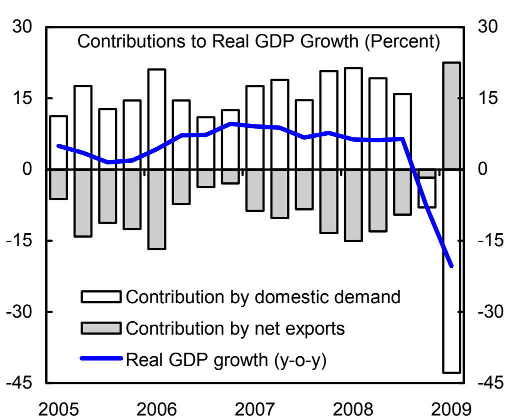
- The mission urged the authorities to implement consistently the flexible exchange rate policy. The current monetary policy stance is broadly appropriate, considering the potential build up of a large monetary overhang against the backdrop of subsiding inflation and exchange rate pressures.

- The bank restructuring program is progressing as planned. The authorities have finalized the resolution strategy for five systemic problem banks, started implementation of the strategy, and prepared necessary legal amendments to strengthen the bank resolution process to resolve swiftly the many smaller insolvent banks.

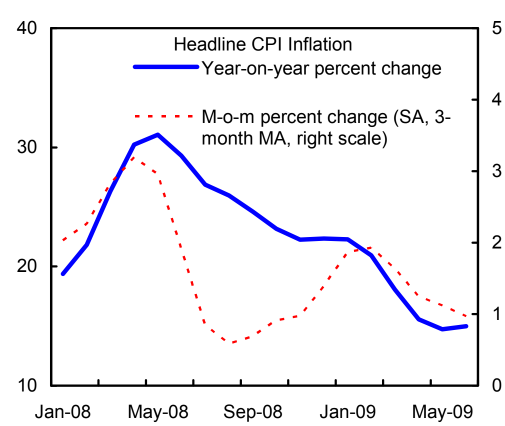
4. **The fragility of the political situation presents significant program implementation risks**. The sharp decline in government revenues and the financial position of Naftogaz has led to fiscal pressures while effective policy implementation is constrained by the fragile political consensus. Moreover, pressures for fiscal relaxation ahead of the Presidential elections, now scheduled for January 2010, are already on the rise.

II. Recent Developments and Outlook

5. **Economic activity plunged in late 2008 and has fallen further in early 2009 (**Table 1, Figure 1**).** Real GDP fell 20.3 percent year-on-year in the first quarter of 2009, reflecting the deterioration of the global environment and further exacerbated by Ukraine's pre-existing vulnerabilities (Table 2). As in many other countries in the region, the recession was led by a drop in export volumes, followed by a very sharp contraction of domestic demand. Against this background, price pressures are easing fast, with headline CPI inflation at 15 percent year-on-year in June, down from 22.3 percent in January (Figure 2).

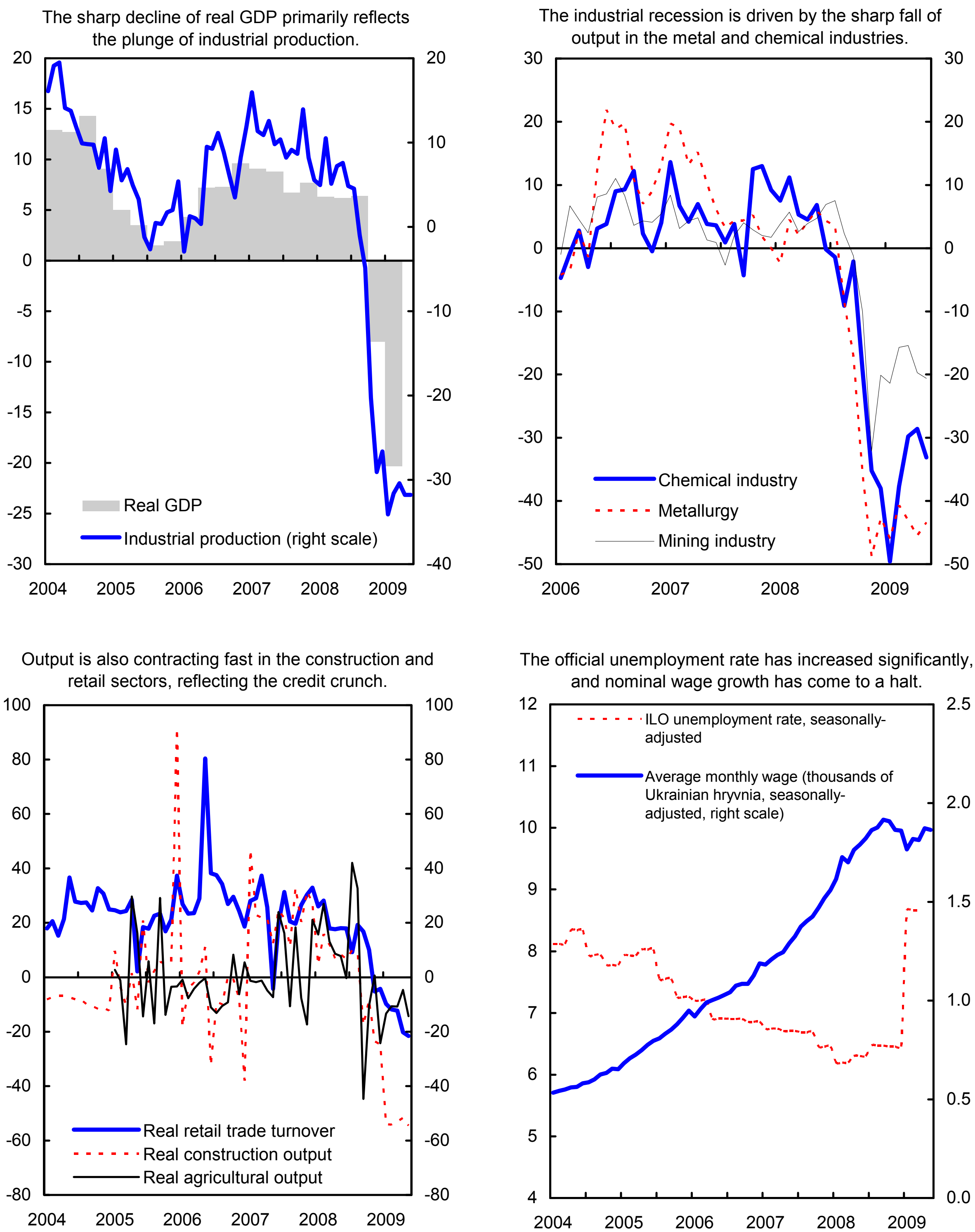


Source: State Statistics Committee.



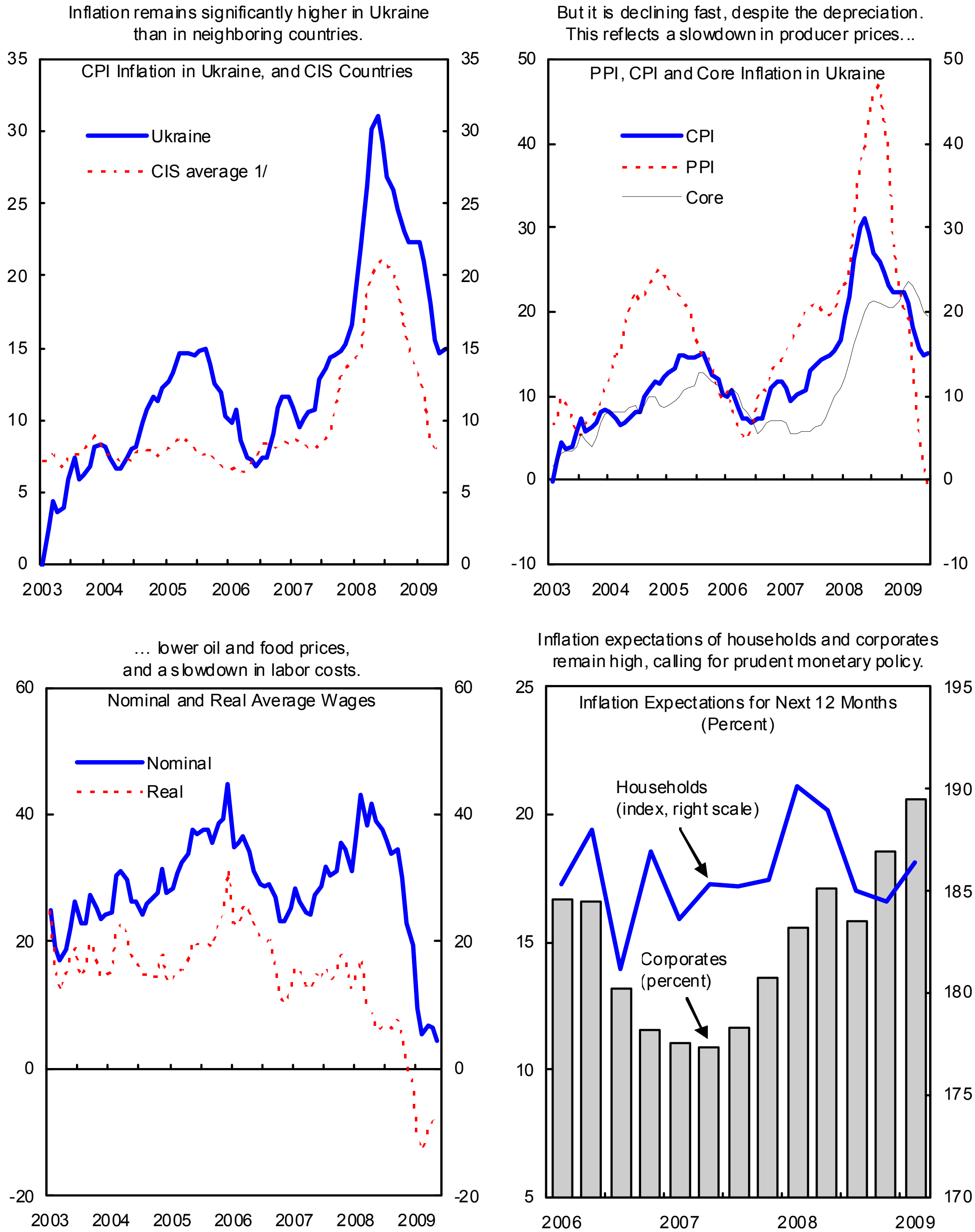
Sources: State Committee of Statistics; and IMF staff calculations.

Figure 1. Ukraine: Real Sector Indicators, 2004–09
(Year-on-year percent change, unless otherwise indicated)



Sources: Ukrainian authorities; and IMF staff calculations.

Figure 2. Ukraine: Indicators of Inflation, 2003–09
(Year-on-year percent change, unless otherwise indicated)



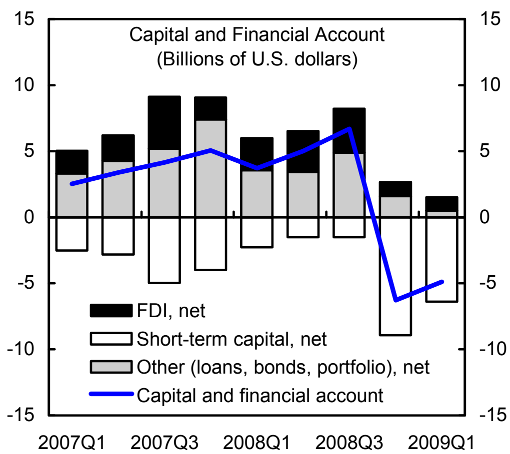
Sources: Ukrainian authorities; and IMF staff calculations.
1/ Data for April, 2009 is based on available data.

6. **Balance of payments pressures receded after large outflows in the fourth quarter of 2008 and the first quarter of 2009** (Table 3, Figure 3)**:**

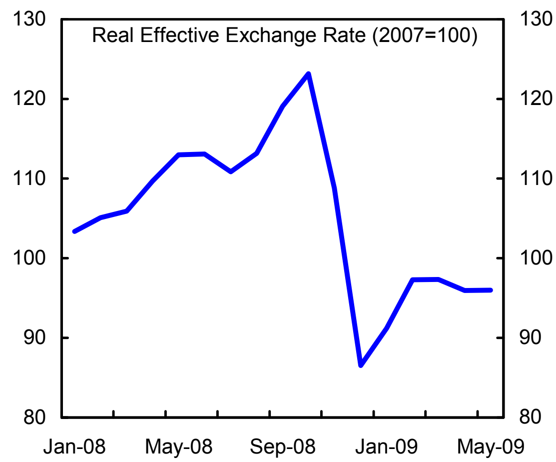
- The current account has continued to adjust, registering a small surplus in April-May. Import volumes declined sharply due to contraction of domestic demand offsetting the decline in exports due to continued weak external demand, especially for steel.

- The financial account has shown signs of stabilization, despite a sharp decline in FDI. External debt rollover rates for the first five months of the year held up well (about 70 percent for banks and 100 percent for corporations). In addition, outflows of foreign exchange from the banking system have receded in recent months.

- The exchange rate has depreciated by about 35 percent in nominal effective terms since early September 2008 and has been stable in recent months, allowing the NBU to scale back interventions since March 2009. More recently, in late June, however, moderate exchange rate pressures have reemerged. The end-May NIR floor was respected with a $1.1 billion margin.



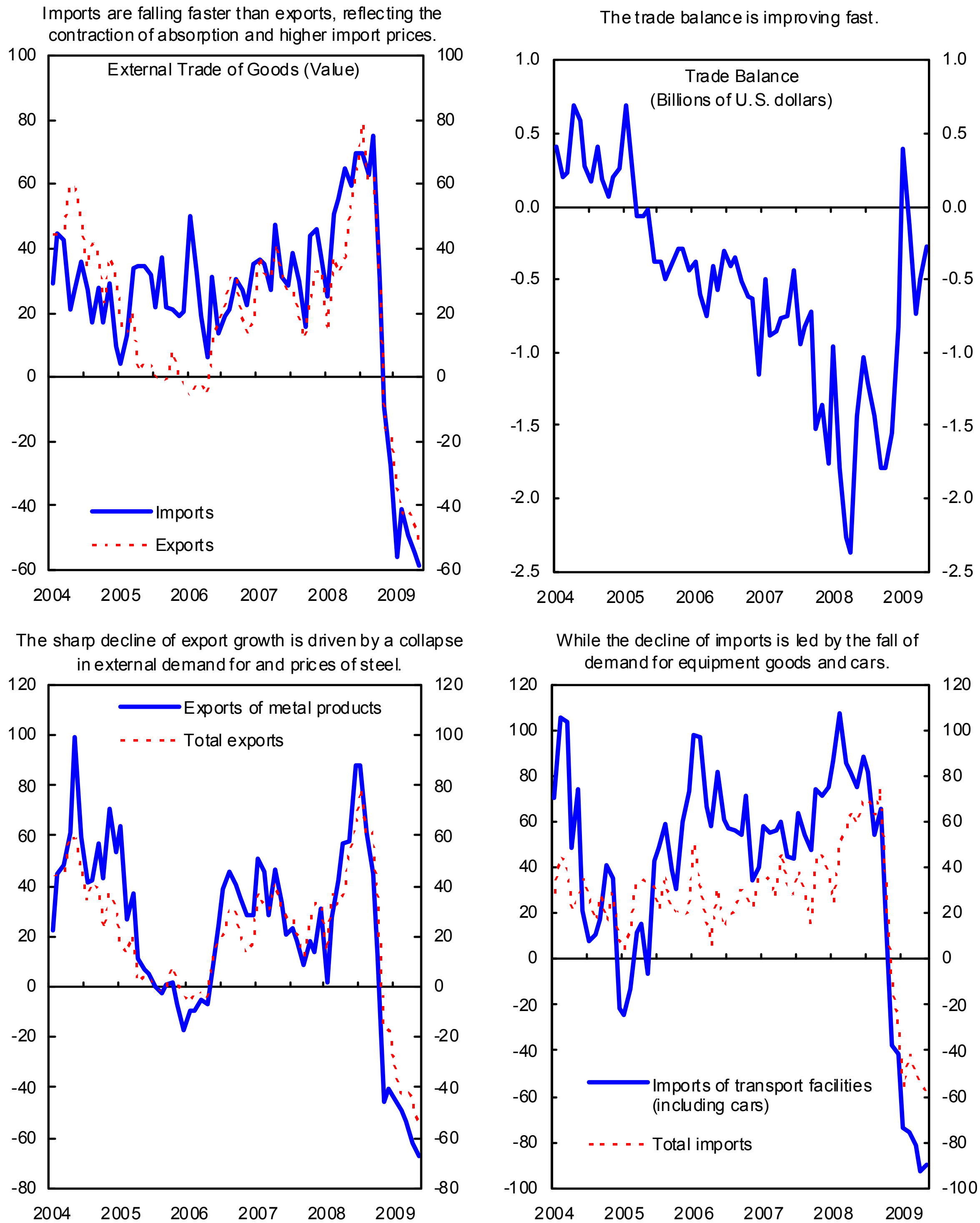
Sources: National bank of Ukraine; and IMF staff estimates.



Source: IMF staff calculations.

7. **The end-May fiscal target was met, but the underlying fiscal situation has continued to worsen** (Table 4)**.** The general government deficit was 1.8 percent of GDP during the first five months of 2009, against a program ceiling of 2.4 percent of GDP (Figure 4). However, this largely reflects an increase in VAT refund arrears and advanced tax payments by large enterprises (0.5 percent of GDP). At end-June, the government deficit stood at 3 percent of GDP. Furthermore, expansionary fiscal measures are being considered ahead of the elections. The government has adopted a moratorium on tax audits (see ¶15) and considered a tax amnesty, while parliament adopted modifications to the budget code implying additional transfers to local governments (which could exceed 1 percent of GDP in 2010). A draft law including large increases in public wages and pensions (2 percent of GDP in 2009, and 4 percent of GDP in 2010) has been suggested by the opposition.

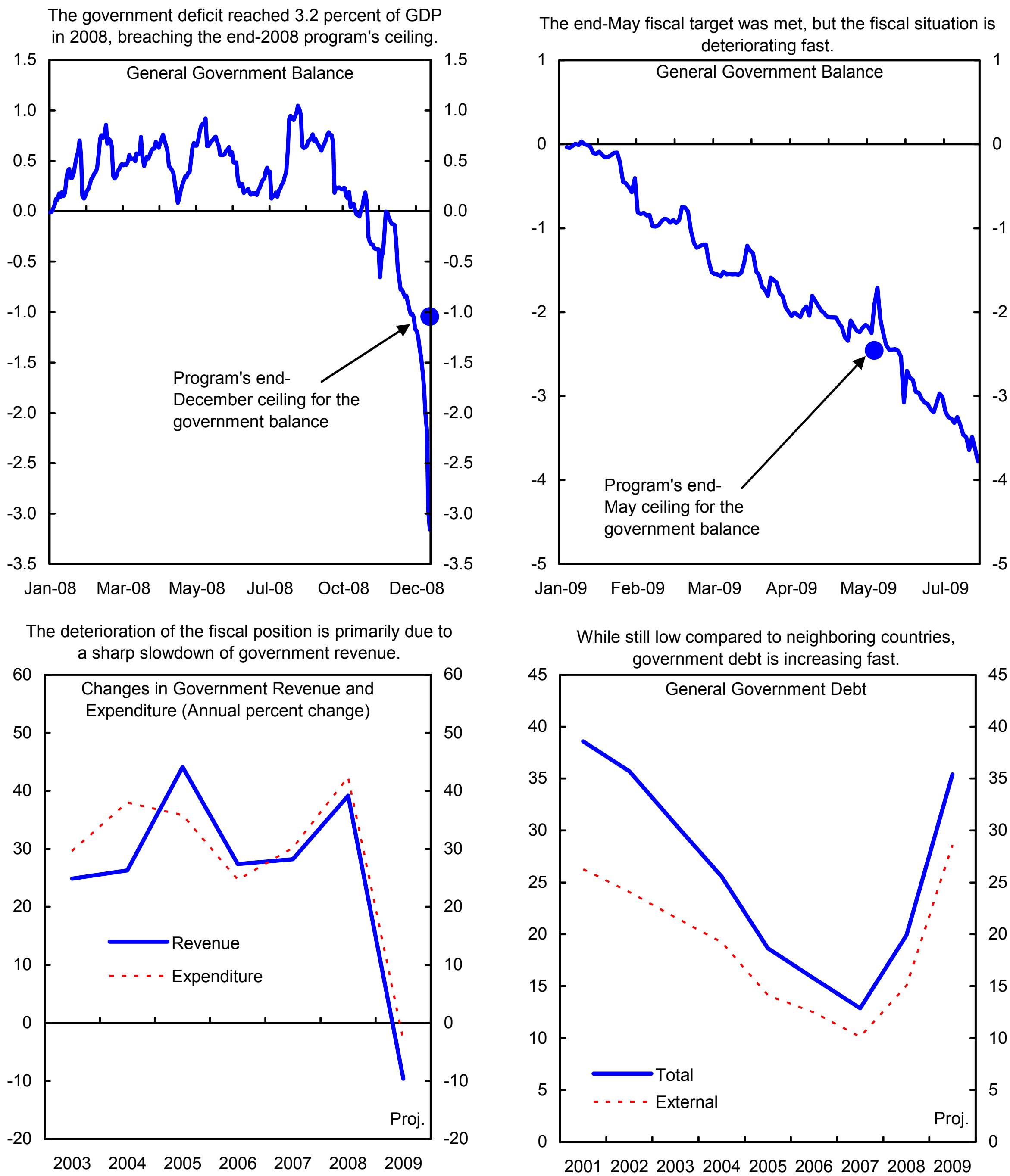
Figure 3. Ukraine: External Trade Developments, 2004–09 1/
(Year-on-year percent change, unless otherwise indicated)



Sources: Ukrainian authorities; EMED; and IMF staff calculations.

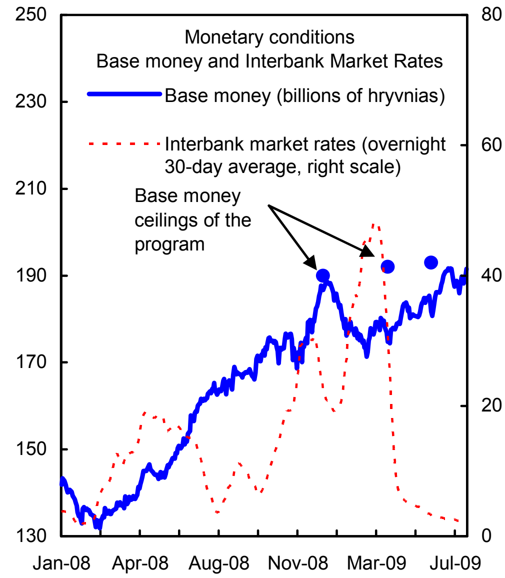
1/ The import data for January are adjusted by $973 million for shift of ownership of gas in storage from a foreign owned entity to Naftogas.

Figure 4. Ukraine: Fiscal Indicators, 2001–09
(Percent of GDP, unless otherwise indicated)



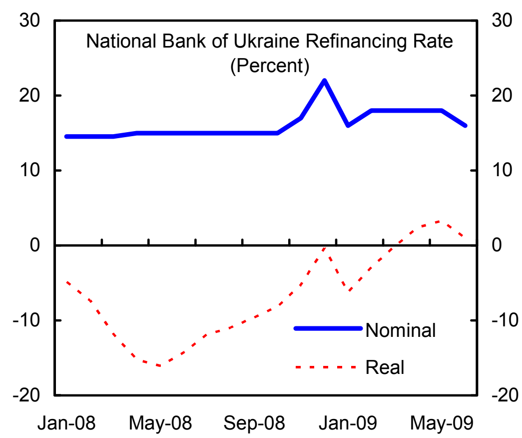
Sources: Ukrainian authorities; and IMF staff calculations.

8. **Liquidity support to the banking system has been reduced since April 2009** (Table 5, Figure 5). Banks' excess reserves nearly doubled in recent months, albeit from very low levels. Interbank interest rates have dropped from peaks over 70 percent in early March to around 3 percent in June, however activity remains limited as the interbank market is highly segmented with only a few large banks trading with each other. Against this background, the demand for NBU refinancing has fallen and the provision of new refinance credits by the NBU has slowed, except for a large-size operation in mid-June related to the financing of Naftogaz. The stock of outstanding refinance credits remains high, however, amounting to about 9 percent of GDP at end-May.



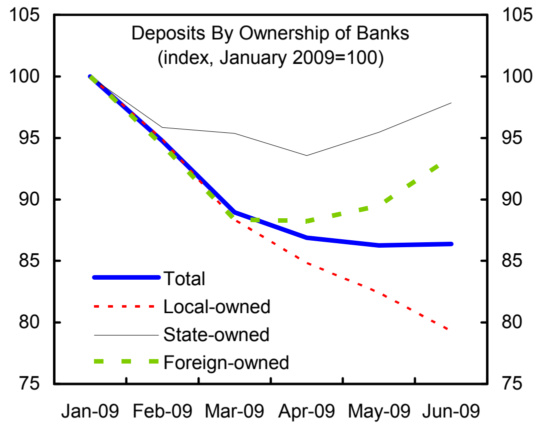
Sources: National Bank of Ukraine; and IMF staff estimates.

9. **Against the backdrop of falling inflation, the authorities reduced key policy interest rates**. In June, they lowered the discount rate by 100bp to 11 percent and the main overnight refinance rate was reduced to 18 percent. Meanwhile, base money has picked up significantly, largely on account of the government's conversion of its share of the second Fund disbursement into hryvnia, but the end-May 2009 ceiling was met with a significant margin. Despite the recent surge in base money, broad money growth has been weak, reflecting a strong liquidity preference on the part of banks, and weak credit demand. (Figure 6).

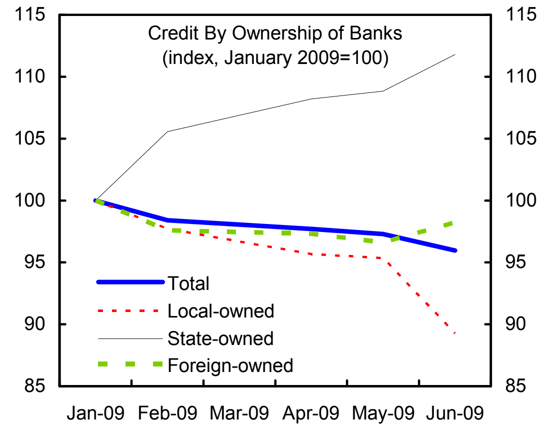


Sources: State Committee of Statistics; and IMF staff calculations.

10. **The banking system remains under strain, but deposits have stabilized, signaling some return of confidence** (Table 6)**.** NPLs have increased since the onset of the crisis, but many banks report successful restructuring of their credit portfolios. After loosing some 20 percent of deposits between October 2008 and April 2009, aggregate deposits have stabilized in recent months, allowing the authorities to lift the ban on the early withdrawal of time deposits. The stabilization at the aggregate level conceals significant differences between banks, with the recently recapitalized state and foreign owned banks generally gaining deposits, while the domestic banks continue to experience significant outflows. Domestic currency lending has been picking up recently but this is fully on account of lending by the state banks while other banks continue to reduce their credit portfolios.



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



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

III. Policy Discussions

A. Macroeconomic Framework

11. **The macroeconomic framework for 2009 has been revised:**

- ***Real GDP is projected to decline by 14 percent in 2009***, against 8 percent expected at the time of the first review. The revision reflects the larger than expected contraction in the first quarter of 2009. Given the pronounced recession in Ukraine's main trading partners and the likely frail global demand for steel in the coming quarters, the forecast assumes only a very gradual recovery in the second half of 2009.

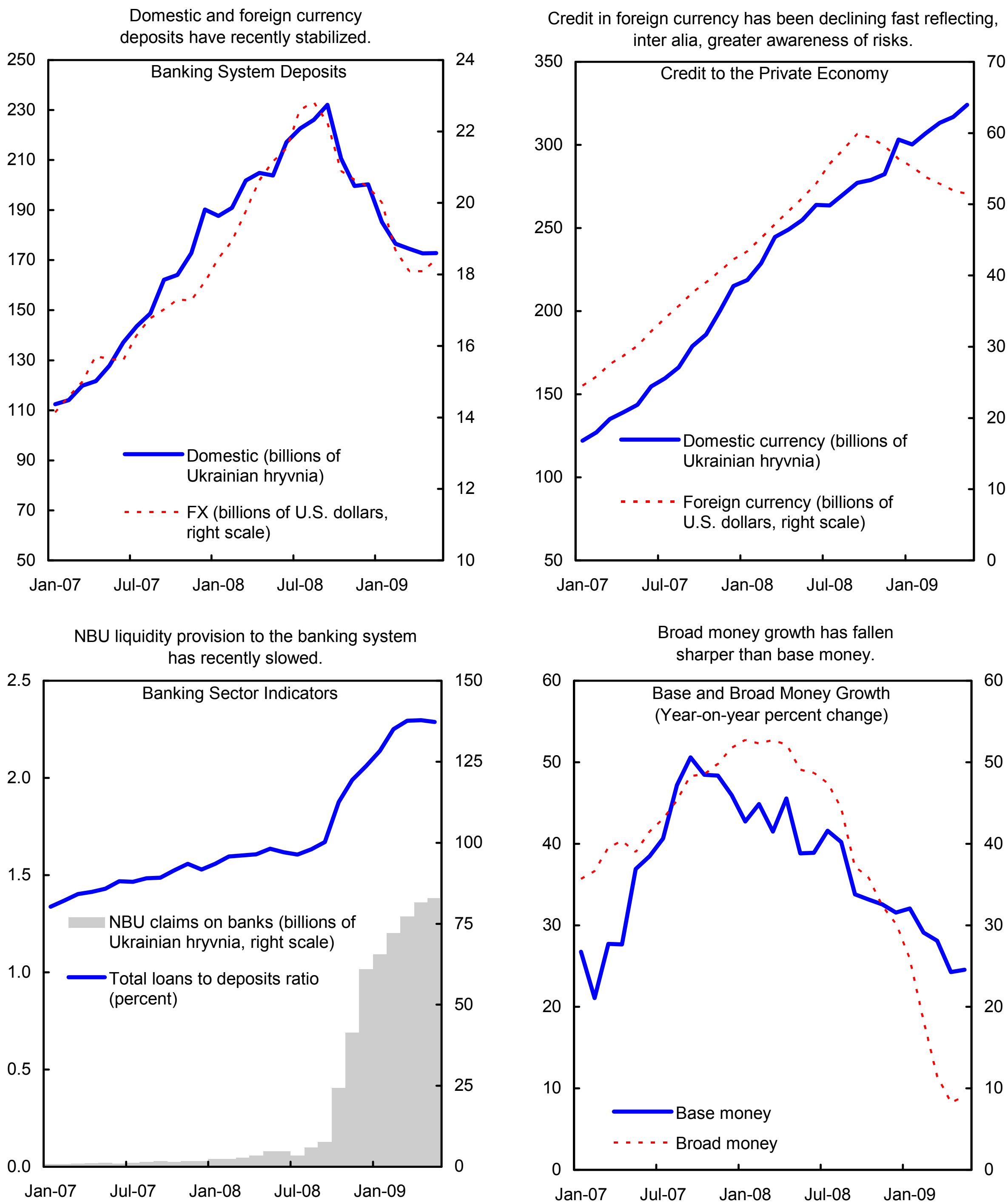
Revised Macroeconomic Framework, 2008–10

	2008	2009		2010	
	Est.	1st Review	Rev.	1st Review	Rev.
	(Percent change, unless otherwise indicated)				
GDP growth	2.1	-8.0	-14.0	1.0	2.7
Domestic demand	8.0	-18.8	-24.8	2.2	4.0
CPI (end of period)	22.3	16.0	14.0	8.0	9.0
Average real wage	6.8	-11.2	-11.0	-2.5	-1.2
REER	12.6	…	…	…	…
Currrent account (percent of GDP)	-7.2	0.5	0.6	1.2	0.1
Export volume (goods) 1/	-1.9	-8.8	-13.6	5.8	6.1
Import volume (goods) 1/	16.8	-31.8	-36.4	5.6	6.6
Terms of trade (goods) 1/	8.0	-13.6	-13.6	3.0	-2.1

Sources: SSC; and IMF staff estimates and projections.

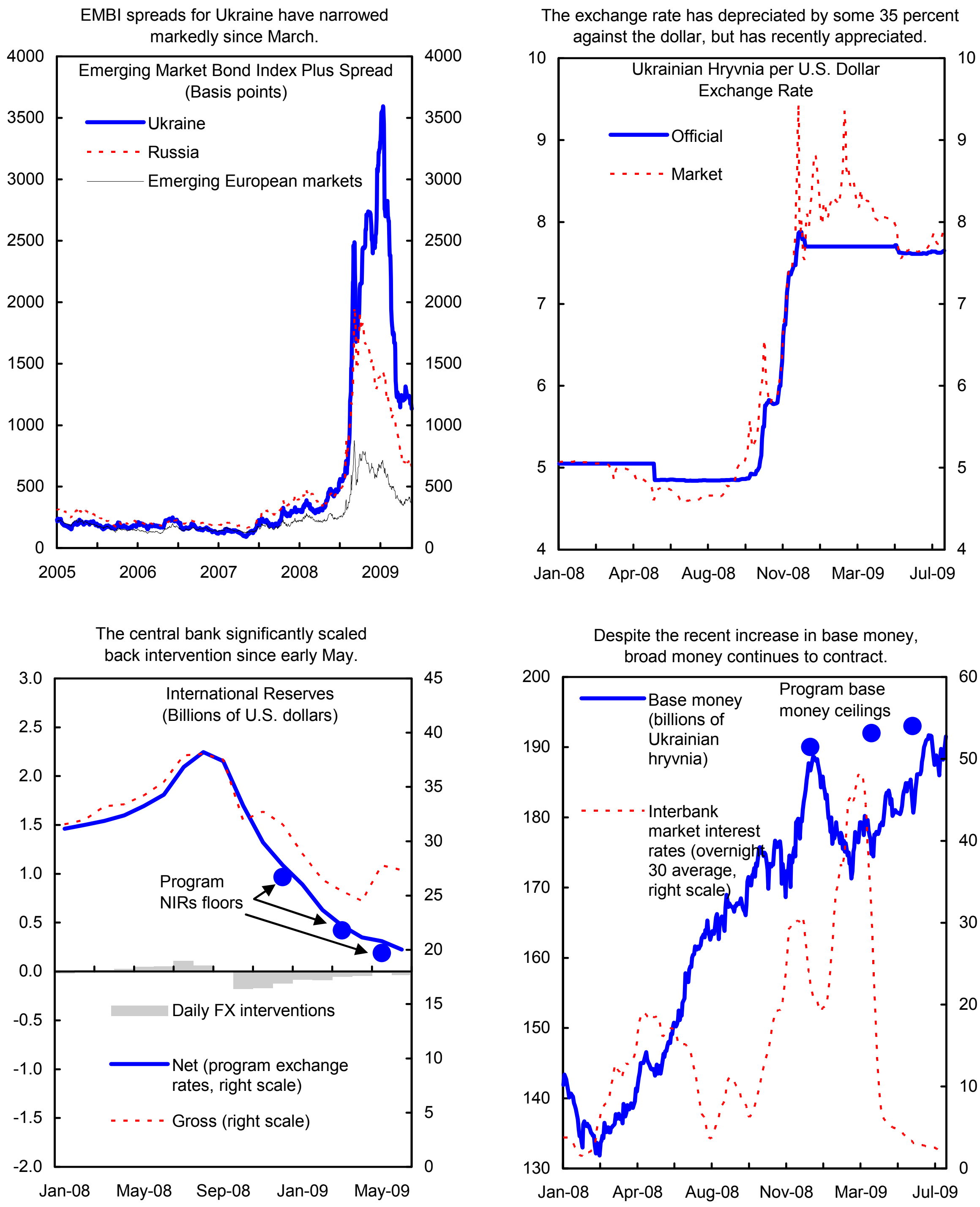
1/ For 2008, staff estimates based on balance of payments data.

Figure 5. Ukraine: Banking System Indicators, 2007–09



Sources: Ukrainian authorities; and IMF staff calculations.

Figure 6. Ukraine: Monetary and Financial Indicators, 2005–09



Sources: Ukrainian authorities; and IMF staff calculations.

- ***Inflation pressures are expected to decline***, reflecting the larger output gap. However, base effects from the second half of 2008 will slow the decline in headline inflation, which is expected at 14 percent by end-2009.

- ***The current account balance is expected to swing into a small surplus in 2009 (½ percent of GDP)***. However, relative to the first review, the drop in both import and export volumes is expected to be larger owing to the weaker domestic and external outlook. Lower FDI is broadly offset by lower net outflows of bonds and loans. The assumed 2009 rollover rates for bank and corporate debt remain at 70 percent and 80 percent, respectively, which is conservative given developments thus far. GIR at end-2009 is projected at $30 billion, or 90 percent of maturing debt in 2010.[1]

Rollover of Private External Debt, 2009

Comparison with program assumptions 1/

	Rollover Rates (Percent)	
	1st Review	2nd Review
Banks	70	70
Foreign banks	85	80
Domestic banks	30	35
Corporates	80	80
Multinational	90	85
Others	70	70
Aggregate	70	70

Sources: IMF staff.

1/ Rollover rates are rounded to the nearest 5 percent.

- ***The program remains adequately financed, but there are risks***. Total financing requirements in 2009 are projected to amount to $41 billion, while total financing sources (excluding Fund resources but including $2.3 billion in prospective official financing) amount to $31 billion. This leaves a financing need of about $10 billion, which could be fully met by Fund resources (see table). Risks include lower-than-expected official financing, renewed foreign currency cash outflows from the banking system, and reduced FDI inflows and rollover rates. If these risks materialize, use of reserves buffers and/or additional policy adjustment would be needed.

12. **In line with the outlook for the region, a more vigorous recovery is not expected before the second half of 2010** (Table 7)**.** Improvements in competitiveness following the real exchange rate depreciation, a recovery of steel prices, and higher public and private investment related to infrastructure and energy projects would be the main drivers of the recovery. Inflation is projected to be in single digit in 2010 and in the 5–7 percent range thereafter (Table 5). The current account balance would remain at financeable levels, and the financial account deficit would narrow as capital inflows recover. The recovery could be delayed, however, in the case of an unexpected further decline in steel prices or another round of stress in global financial markets. On the other hand, a faster global recovery and a return of political stability after the January election could result in a more pronounced rebound of the economy.

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[1] Short-term debt on a residual maturity basis for 2010 has been revised down.

Program Financing, 2009

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

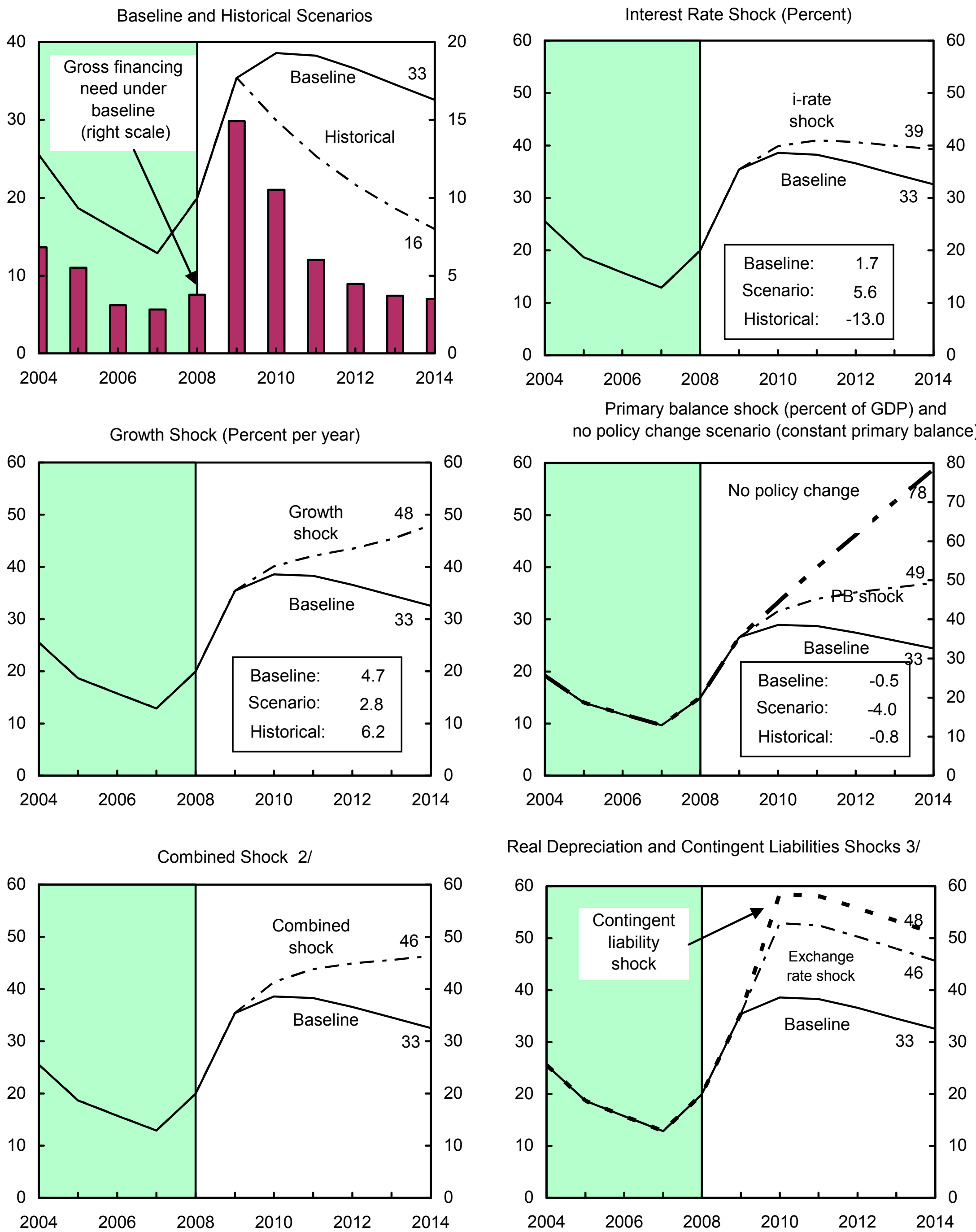
	2009
Total financing sources	31,114
Net FDI (including capital transfers)	4,070
Portfolio, net	-80
Debt financing, total	26,465
Private	21,905
Official	4,560
Of which:	
World Bank	1,250
Project financing	500
Unidentified multilateral and bilateral	2,250
Other 1/	560
Reserve accumulation (-denotes increase)	659
Total financing requirements	41,191
Current account deficit	-710
Total amortization (includes short-term debt, trade credit, and medium- and long-term amortization)	35,250
Amortization of private debt	32,262
Amortization of government debt	2,988
Other capital outflows	6,651
Financing need	10,077
Fund credit (net)	10,077
Gross reserves	30,000
Gross reserves (percent of short-term debt at remaining maturity in 2010)	90
Gross reserves (months of next year's imports)	5.5

Sources: Ukrainian authorities; IMF staff estimates and projections.

1/ Includes official debt restructuring.

13. **External and public debt remain sustainable but caution is warranted going forward especially in the context of financing constraints** (Tables 8 and 9, Figures 7 and 8). While Ukraine's low level of public debt—20 percent of GDP in 2008—provides room for letting automatic stabilizers cushion the downturn and absorb part of the bank restructuring costs, fiscal sustainability could become a concern under unchanged policies, especially if the recession turned out more protracted than currently envisaged. Failure to implement the agreed measures in 2010 (pension-, tax-, and gas sector reform) or new expansionary measures could potentially jeopardize public debt sustainability in the longer run. The baseline external DSA shows a rapidly declining external debt ratio but further deterioration in global economic and financial conditions, adverse current account developments, possible further shortfalls in FDI, or exchange rate overshooting would negatively affect debt dynamics.

Figure 7. Ukraine: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP, unless otherwise indicated)



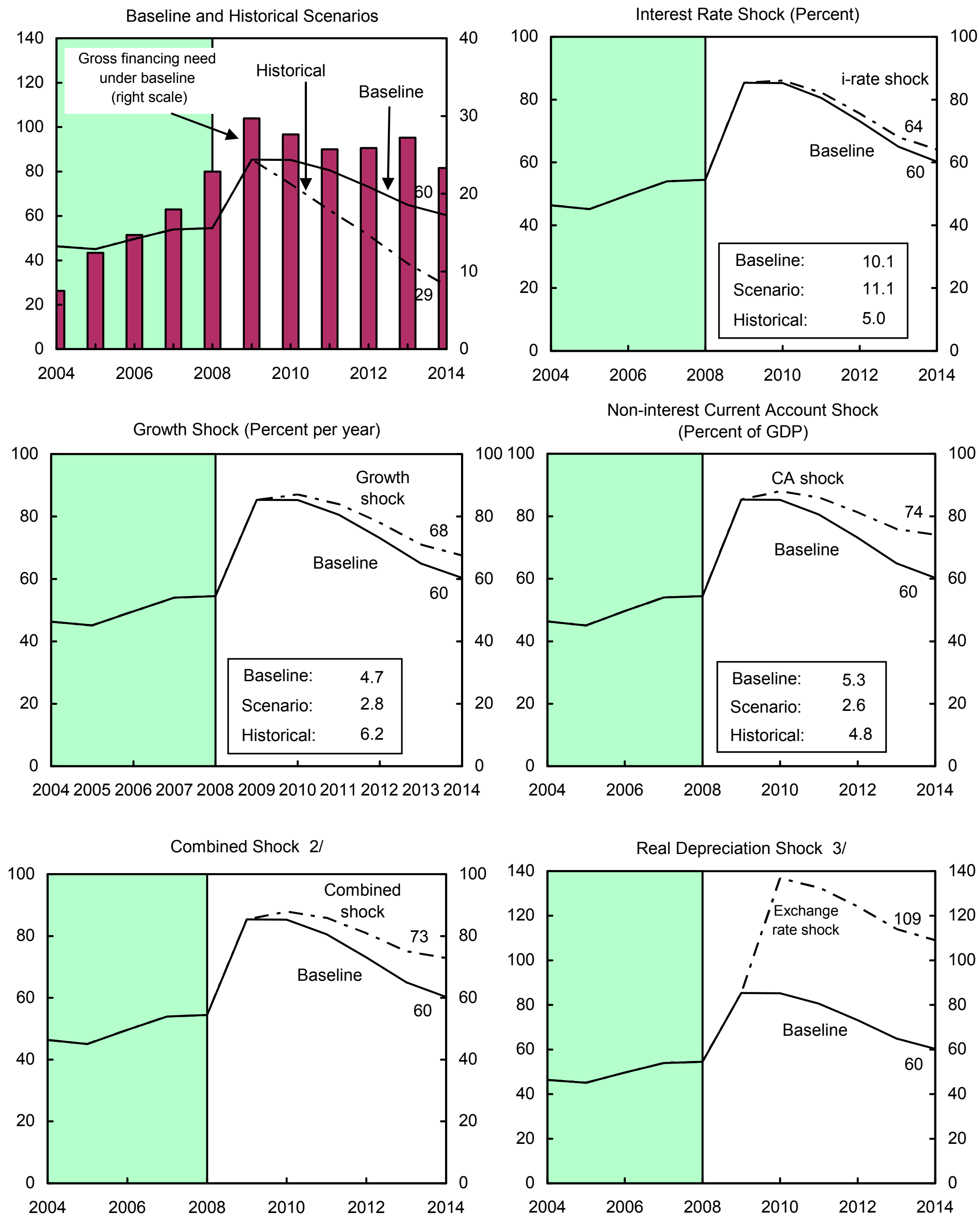
Source: IMF staff estimates.

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 primary balance.

3/ In line with standard IMF stress tests, the exchange rate shock simulates the impact of a one-time real depreciation of 30 percent. The contingent liability shock simulates a 20 percent GDP shock (associated with, e.g., bank restructuring costs and/or lost savings in USSRs Savings Bank) occuring in 2010.

Figure 8. Ukraine: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



Sources: 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.

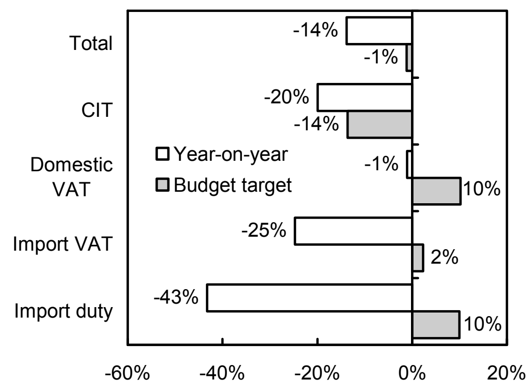
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

3/ In line with standard IMF stress tests, the shock simulates the impact of a one-time real depreciation of 30 percent in 2010.

B. Fiscal Policy

14. **The outlook for public finances has worsened significantly.** The revised GDP growth projection implies that, without offsetting measures, the general government deficit would increase from 4 to 6.5 percent of GDP in 2009. Given the large fiscal risks implied by the financial situation of Naftogaz and the progress made in collecting data to monitor it, the fiscal aggregates under the program have been broadened to include the deficit of Naftogaz (about 2.7 percent of GDP in 2009; Box 1). Overall, without corrective measures, the 2009 public sector deficit (inclusive of Naftogaz' deficit but excluding bank restructuring costs) would reach 9.2 percent of GDP.

State Budget Revenues, end-June (General Fund)



Sources: Ministry of Finance; and IMF staff estimates.

Box 1. Financial Situation of Naftogaz

Financial situation of Naftogaz

In 2009, Naftogaz (NG) is expected to have an operational deficit of UAH 25 billion (2.7 percent of GDP), reflecting the gap between domestic and imported prices as well as the lower than expected sales to industry and a rise in payment noncompliance by utility companies.

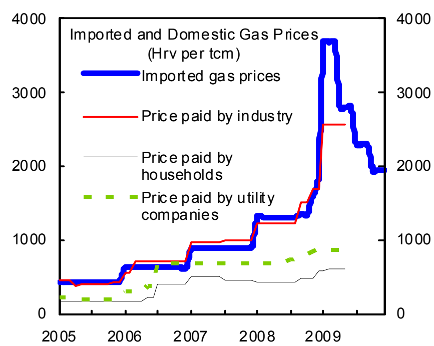
Recent developments.

On June 29, the European Commission convened a meeting in Brussels to discuss ways to help NG secure financing to pay for the additional storage gas. Europe relies on Russia for about 25 percent of its gas imports, 80 percent of which flow through Ukraine. Participants, including the WB, EBRD, EIB, stressed that any financial assistance to NG would be contingent on continued reform of its gas sector.

Treatment under the Program

The BOP projection incorporates 33bcm in gas imports, in line with the contract between NG and Gazprom. Considering the risks implied by NG finances for the sustainability of public debt, staff proposes to broaden the fiscal aggregates under the program to cover the company. The program also includes a prior action to improve the transparency of NG, including the adoption of a revised financial plan, a monitoring scheme, and a restructuring strategy to be developed in consultation with the World Bank, EBRD, EIB under the political leadership of EU (as agreed under the Brussels Declaration, March 23, 2009).

Even though gas prices have fallen from highs in early 2009, they remain high compared to historical trends.



Sources: Ukrainian authorities; and IMF staff calculations.

15. **The revised program sets the 2009 fiscal deficit target for the public sector (inclusive of Naftogaz' deficit but excluding bank restructuring costs) to 8.6 percent of GDP—6 percent of GDP for the general government and 2.6 percent of GDP for Naftogaz** This implies a broadly unchanged fiscal stance relative to 2008 as measured by the cyclically-adjusted balance (Table 4). Staff and the authorities agreed that in light of the severe financing constraints, fiscal consolidation measures were needed. This was particularly important with a view to 2010 when the crowding-out of private sector borrowing that would be associated with a continued high fiscal deficit would risk hampering the expected economic recovery. To signal their commitment to fiscal discipline, the authorities have issued a declaration stating their determination to consolidate public finances. The authorities are committed to take measures reducing the deficit by 0.6 percent of GDP in 2009. Half of these measures are permanent, with an estimated impact of 0.7 percent of GDP on an annual basis. The authorities have also taken concrete steps to prepare the implementation of structural reforms in 2010 (see Table 11):

- To improve the financial position of Naftogaz, the authorities have taken the decision to capitalize the company and announced an increase in gas tariffs paid by households and utilities by 20 percent, effective on September 1 and October 1, respectively. This will bring these tariffs to 31 and 43 percent of import prices. They also announced quarterly 20 percent price increases starting in January 2010 (implying 1 percent of GDP savings in 2010), which would bring tariffs to 60 and 80 percent of projected end-2010 import prices, respectively. A task force has been created to better target the existing social safety net programs to effectively protect vulnerable households.

- The government has taken the decision to increase electricity tariffs and reduce spending in non-priority areas (goods and services). They are also planning to undertake measures to strengthen tax administration in line with IMF Technical Assistance advice. This will involve adopting a national tax compliance improvement plan that will, inter alia, aim to strengthen large taxpayer administration, enhance VAT administration, and intensify arrears collection. The authorities committed not to enact a law that envisaged infrastructure financing from advance NBU profit transfers and a budget code that would have led to a disorderly fiscal decentralization process, not to introduce any tax amnesty nor implement a moratorium on tax audits, and to keep goods and services spending in line with budgeted amounts (in particular regarding payments to contractual workers).

- The authorities have adopted a time-bound road map describing the schedule and main steps in the design of pension and tax reforms. They have committed to issue, by end-September, a comprehensive analysis of the situation of the pension system and of the tax system, on the basis of which they intend to formulate concrete policy actions by end-October 2009, which would be implemented as part of the 2010 budget.

16. **The authorities and the mission agreed on a fiscal deficit target of 4 percent of GDP (including transfers to Naftogaz) for 2010.** Without measures, the deficit would be expected to reach 6.5 percent of GDP in 2010, compounding the adverse medium-term debt dynamics. Full implementation of the gas price increases and the reductions in current expenditure agreed in the context of the current review would bring the public sector deficit to 5.5 percent of GDP in 2010. The authorities have committed to achieving additional savings of 1.5 percent of GDP through the structural reforms planned for next year (pension reform, tax reform), further moderation in current spending.

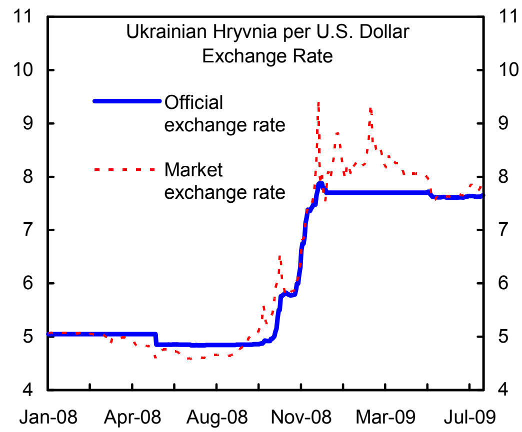
17. **The authorities also committed to take structural measures to strengthen the financial situation of Naftogaz and to restructure the company**. They have adopted a revised 2009 and a projected 2010 financial plans for the company which, in addition to the gas price increases mentioned above, envisages measures to increase payment discipline by households and utility companies, and a strengthened mechanism to set heating tariffs. They have commissioned an international audit firm to put in place a monitoring framework for the finances of Naftogaz and to establish a regular (monthly) and timely reporting of key financial data. In accordance with the principles agreed with the European Union in the March 23, 2009 Brussels declaration, the authorities have committed to restructure Naftogaz, including by adopting separate cost centers for gas imports, domestic gas production and gas transit, as well as a mechanism for transparent financing of gas transit modernization. This strategy will be implemented on a strict timetable.

18. **Despite some progress, the authorities continue to face challenges financing the budget deficit.** They have been able to place increasing amounts of domestic debt in recent weeks, as the bonds have carried interest rates more in line with market rates, and have worked on procedures and instruments to develop a domestic debt market. They also plan to launch significant privatizations. However, as of end-June, the authorities have almost depleted their deposit accounts and allocation of further IMF disbursements to the budget is needed to ensure sufficient financing in the months ahead.

19. **The use of Fund resources to support the budget plays an essential role in smoothening the required fiscal adjustment and cushioning its impact on the economy, but will have to be phased out going forward.** While the use of Fund resources is key at the moment given the weak state of the economy, the increased risks to debt sustainability, the opaqueness of Naftogaz finances and the shallowness of the domestic bond market argue for caution and the need to create enabling conditions for a successful exit from Fund support to the budget. This reinforces the importance of the structural fiscal reforms that the authorities have committed to and the need to mobilize additional financing sources. Indeed, the mission urged the authorities to develop instruments to tap savings outside the banking system ("mattress money") and to strengthen their efforts to secure additional funding from multilateral and bilateral creditors.

C. Monetary and Exchange Rate Policy

20. **The authorities are taking measures to improve the functioning of the foreign exchange market but continue to resort to administrative controls and moral suasion.** In line with their commitment at the time of the first review, they have aligned the official exchange rate with the market rate of the previous day (within a 2 percent margin). With the stabilization of the foreign exchange market, interventions have slowed down markedly. The NBU continued its auctions of foreign exchange aimed at facilitating the repayment of external debts by households and SMEs. These developments notwithstanding, actual exchange rate flexibility has been very limited in recent months, partly reflecting improvement in confidence but also moral suasion from the NBU. The authorities committed to revoke shortly the ban on FX forward and spot transactions (introduced in April) and to bring regulations on open foreign exchange positions in line with international good practices.



Source: National Bank of Ukraine.

21. **The monetary policy stance is broadly appropriate.** With the economy in deep recession, credit demand weak, and with liquidity being hoarded by banks, inflationary pressures are contained for the time being. Staff and the authorities concurred that the prevailing policy rates struck an adequate balance between the desirability of providing stimulus to the economy on the one hand and containing inflation expectations and exchange rate pressures on the other. There was agreement that a further reduction in policy rates was not prudent at this time given the deteriorating fiscal balances and the payment problems of Naftogaz. The deteriorating fiscal deficit and the payment problems of Naftogaz pose risks to the monetary outlook. Against this background, it was agreed that the authorities would closely monitor developments in monetary aggregates and bank liquidity and avoid the build up of a large monetary overhang that could result in instability in the foreign exchange market or cause inflation. It was agreed that the NBU would stand ready to raise policy rates if the downward trend in inflation were unexpectedly interrupted or in the case of a reemergence of strong exchange rate pressures.

22. **A special review of refinancing and foreign exchange interventions of the NBU was completed.** The review, which was conducted by a reputable external auditor, suggests that NBU had broadly followed approved procedures and authorization policies in conducting these operations. The results have been shared with the IMF and the NBU will publish the main findings in accordance with the terms of reference for this engagement.

23. **The authorities confirmed their intention to strengthen the independence of the NBU, in line with their commitments under the program.** In particular, they plan to enact legislation to strengthen the overall governance structure of the NBU by end-September 2009 (this implies some delay relative to the original program, owing to the prioritization of bank resolution efforts and related legislation). A Fund technical assistance mission to help prepare the legislation is planned for July-August, 2009. The authorities also committed to refrain from enacting legislation that impinged on NBU independence—such as the recent proposal that financed infrastructure spending from advance NBU profits—and to vetoing any initiatives to this effect from parliament.

D. Financial Sector Policy

24. **The authorities' bank restructuring program is progressing.** The resolution strategies for the five systemic problem banks have been finalized. Diagnostic studies for the nonsystemic banks have been completed on time and the legislative changes necessary to ensure effective bank resolution have been prepared. The initial public cost of bank restructuring is estimated at around UAH 25–30 billion (about 3 percent of GDP) in addition to the capitalization of the state banks Oschadbank and Eximbank of about UAH 15 billion (about 2 percent of GDP). Efforts to enhance supervision and data transparency are underway, but progress has been slow as the bank restructuring work takes priority.

25. **Most systemic banks have injected the necessary regulatory capital ahead of schedule and the remaining are put on a time-bound action plan.** For the systemic banks (which account for about 85 percent of capital of the banking system), the shareholders of most private banks have committed to inject the necessary capital totaling about UAH 21.5 billion ($2.6 billion) and have already brought in the necessary capital ahead of schedule. NBU has put several banks under enhanced monitoring and restricted their activities until they fully comply with the relevant regulations. It is also following up closely with the respective shareholders to ensure that the remaining capital pledges are received. A specific unit within the NBU has been formed to oversee this process.

26. **The authorities are committed to a swift resolution of systemic problem banks.** The shareholders of seven domestically-owned banks were not able to commit initially to injecting the additional capital and the NBU has initiated measures to safeguard bank assets in these banks, including the introduction of temporary administration. The shareholders of two of these banks found the criteria for state involvement too onerous and have opted to raise the required capital by their own means. The authorities have put together a resolution strategy for each of the remaining five systemic problem banks and have started implementation. Capital needs of these banks have been calculated at about UAH 20 billion by international audit firms based on an update of the diagnostic study results and the banks will undergo a thorough due diligence that includes an assessment of restructuring options post-recapitalization. For three of these banks the resolution strategy is being implemented, including the dilution of the shares of existing shareholders to an agreed

value, recapitalization by the government and appointment of a professional management. For two other banks, restructuring of debt to external creditors needs to be advanced ahead of the finalization of the resolution strategy. To ensure rapid progress of the restructuring process, the authorities have completed the setup of the relevant units at the MoF and the NBU.

27. **The two existing state banks have been recapitalized** in line with the diagnostic results and have received extra capital cushion. However, recent quasi fiscal operations, including large exposures to state-owned enterprises may have implications for the financial position of these banks. The authorities agreed to follow up with a due diligence of the banks, and to design a restructuring strategy as needed on the basis of the results.

28. **The diagnostic studies for the nonsystemic banks have been completed.** While the overall capital needs of these smaller banks are manageable, inadequate risk management practices and large amounts of connected lending raise concerns. The shareholders of 31 banks have committed to provide additional capital amounting to about UAH1.6 billion by December 2009. The NBU is in the process of finalizing resolution strategies for those banks that are unable to raise the necessary capital and those that are not in compliance with relevant prudential regulations.

29. **Necessary legal amendments to strengthen the bank resolution process have been planned.** The main objective of these amendments are to enable transfer of assets and liabilities without prior approval of creditors, simplify the process for bank mergers and acquisitions, enable the government to provide funds for banks under resolution by the NBU, and provide the respective staff the necessary immunity while executing their tasks in good faith. The amendments will form the basis for the workouts of the non-systemic insolvent banks and are important to avoid legal risks and procedural delays.

30. **The mission discussed the design of the recapitalization bonds with the authorities.** Under the existing anti-crisis legislation, the NBU is obliged to purchase the recapitalization bonds from the banks if these desire to redeem the bonds for cash. To avoid undue increase in the money base and limit financial risks to the NBU, liquidity needs of the recapitalized banks will be satisfied based on projected needs and an agreed upon schedule.

31. **Measures to strengthen the supervision framework and data transparency are underway.** The authorities are preparing draft legislation and regulations to implement consolidated supervision and provide for supplementary supervision of conglomerates. Also, the authorities have started to publish bank-by-bank data and are committed to start publishing more detailed financial information on banks by September 2009. To improve communications with the home supervisors of parent banks, the authorities plan to complete all pending MoUs with their counterparts by end-2009.

IV. Program Modalities and Capacity to Repay

32. **The attached LOI describes the authorities' progress in implementing their economic program and sets out conditionality though December 2009.**

- Prior actions for the completion of the second review include finalization of the resolution strategy for the systemic problem banks and measures to enable effective bank resolution for other problem banks. Other prior actions include measures to contain fiscal risks related to Naftogaz. Finally, completion of the review will be conditional on the removal of controls on foreign exchange forward transactions.

- The authorities have requested that the disbursement for the second review (SDR 2.1 billion) be channeled to the budget. This will help finance the deficit, including the payment of gas imports from Gazprom.

33. **Staff believes that the program continues to leave Ukraine in a position to fulfill its obligations to the Fund in a timely manner** (Table 10). Fund credit outstanding would peak in 2010 at 55 percent of Ukraine's gross reserves. Peak payments would be in 2012–13 at a still manageable 12 and 25 percent of gross reserves, respectively. In addition, the programmed fiscal adjustment should preserve public debt sustainability. Ukraine's past record also provides comfort as earlier loans have been completely repaid.

V. Staff Appraisal

34. **The sharp recession and the fragile political consensus pose difficult challenges.** The contraction contributes to a rapid improvement of the current account, but it is putting additional stress on the banking system and further weakens government revenue. The deterioration in payment discipline of the households and companies exacerbates the financial constraints of state-owned companies, especially Naftogaz, further compounding fiscal pressures. Moreover, pressures for fiscal relaxation in the run up to the presidential elections in January 2010 are already on the rise. Recent expansionary fiscal initiatives have been contained and it is essential that the government resists such initiatives going forward.

35. **Corrective fiscal measures are a priority to ensure fiscal sustainability and to avoid crowding out of private borrowing.** It is crucial that the authorities take the necessary measures to avoid further slippages relative to the revised target and rapidly achieve progress on structural reforms to reduce fiscal financing needs and avoid a crowding out of private borrowing which could slow the recovery of the economy. Fiscal consolidation would also help safeguard medium-term fiscal sustainability

36. **The adoption of a comprehensive strategy to strengthen the financial situation and restructure Naftogaz is an important step forward.** It is critical that these measures are implemented in line with the agreed timetable.

37. **The staff welcomes the recent measures to improve the functioning of the foreign exchange market, but urges the NBU to remove remaining obstacles to exchange rate flexibility**. It is important for the NBU to implement a flexible exchange rate policy, supported by base money targets and a transparent intervention strategy. Exchange rate flexibility is indispensable in light of the openness of Ukraine's economy but also to discourage dollarization and excessive risk taking by unhedged borrowers. It also allows monetary policy to focus on inflation objectives.

38. **The monetary policy stance is appropriate but the authorities will need to be vigilant.** Monetary policy will remain anchored to the base money targets, which will soon become more binding as the effects of the bank recapitalization program and fiscal deficit financing exert upward pressure on the money base.

39. **Further progress is needed to restore normalcy in the banking system.** Staff welcomes the progress that has been made on the recapitalization of systemic banks and the preparations for the resolution of nonsystemic banks. Swift actions in these areas are critical to regain public confidence and lay the foundation for strengthening of the banking system, which is crucial to facilitate an economic recovery. In light of recent quasi-fiscal operations, it is necessary to review the financial condition of the state banks. In this regard, the staff welcomes the authorities' intention to undertake a due diligence into the financial situation of these banks and to take corrective measures as needed.

40. **The program continues to be fully financed despite the higher fiscal deficit target, but there are risks.** The current account has adjusted sharply and expected external financing remains sufficient to keep reserves at comfortable levels. However, the program is subject to substantial risks. On the external side, these include the potential for adverse regional and/or global developments and shortfalls in assumed official financing. On the domestic side, the difficult political environment continues to pose significant implementation risks.

41. **Implementation of policies consistent with the program provides the best chance for Ukraine to overcome the economic crisis.** Staff supports the authorities' request for completion of the second review under the Stand-By Arrangement.

Table 1. Ukraine: Selected Economic and Social Indicators, 2006–10

	2006	2007	2008	2009	2009	2010
			Est.	1st Review	Proj. 1/	
Real economy (percent change, unless otherwise indicated)						
Nominal GDP (billions of hryvnias)	544	721	950	990	916	1,056
Real GDP	7.3	7.9	2.1	-8.0	-14.0	2.7
Contributions:						
Domestic demand	13.1	17.2	9.1	-22.5	-29.7	4.2
Net exports	-5.8	-9.3	-7.0	14.5	15.7	-1.5
Unemployment rate (ILO definition; percent)	6.8	6.4	6.4	9.9	10.7	10.0
Consumer prices (period average)	9.1	12.8	25.2	17.2	16.3	10.3
Consumer prices (end of period)	11.6	16.6	22.3	16.0	14.0	9.0
Nominal monthly wages (average)	29.2	29.7	33.7	4.0	3.5	9.0
Real monthly wages (average)	18.4	15.0	6.8	-11.2	-11.0	-1.2
Public finance (percent of GDP) 2/						
General government balance 3/	-1.4	-2.0	-3.2	-4.0	-6.0	-3.0
Overall balance (including Naftogaz and bank recapitalization costs)	-1.4	-2.0	-3.2	-10.8	-11.4	-6.4
Overall balance (including Naftogaz operational deficit) 4/	-1.4	-2.0	-3.2	-5.9	-8.6	-4.0
Privatization proceeds	0.4	0.6	0.3	0.3	0.3	0.4
Net domestic financing	-0.3	0.4	2.5	2.5	5.8	2.8
Net external financing	1.3	1.0	0.4	3.2	2.6	0.8
Public debt (end of period) 5/	15.7	12.9	19.9	32.5	35.4	38.6
Of which: external debt (foreign currency denominated)	12.5	10.1	15.0	23.1	25.0	23.8
Money and credit (end of period, percent change)						
Base money	17.5	46.0	31.6	6.6	10.1	9.6
Broad money	34.5	51.7	30.2	3.8	1.5	14.4
Credit to nongovernment	70.6	74.0	72.1	7.8	3.1	2.5
Velocity	2.08	1.80	1.84	1.85	1.75	1.76
Interbank overnight rate (annual average, percent)	3.6	2.3	13.7	…	…	…
Balance of payments (percent of GDP)						
Current account balance	-1.5	-3.7	-7.2	0.5	0.6	0.1
Foreign direct investment	5.3	6.4	5.5	4.6	3.4	3.8
Gross reserves (end of period, billions of U.S. dollars)	22.3	32.4	31.5	29.3	30.0	31.0
Months of next year's imports of goods and services	3.7	3.9	6.4	5.3	5.5	5.2
Debt service (percent of exports of goods and services)	5.1	4.0	2.7	5.6	7.1	4.0
Goods exports (annual volume change in percent)	2.7	3.2	-1.9	-8.8	-13.6	6.1
Goods imports (annual volume change in percent)	12.5	20.3	16.8	-31.8	-36.4	6.6
Goods exports	36.1	34.8	37.7	42.2	38.9	41.0
Goods imports	40.9	42.2	47.1	45.1	41.3	44.6
Share of metals in merchandise exports (percent)	42.2	41.7	40.8	35.5	35.3	34.5
Net imports of energy (billions of U.S. dollars)	8.1	11.5	16.7	13.0	11.5	16.1
Goods terms of trade (percent change)	-0.3	9.0	8.0	-13.6	-13.6	-2.1
Goods and services terms of trade (percent change)	1.5	7.4	8.8	-9.2	-9.1	2.2
Exchange rate						
Exchange rate regime	de facto peg		managed float			
Hryvnia per U.S. dollar, end of period	5.1	5.1	7.7	…	…	...
Hryvnia per U.S. dollar, period average	5.1	5.0	5.3	…	…	...
Real effective rate (CPI, percent change)	4.8	2.6	12.6	…	…	…

Social indicators

Per capita GDP: US$ 2,282 (2006); Poverty (percent of population): 8.0 (2006; World Bank estimate);

Life expectancy at birth: 68.2 years (2006); Infant mortality (per 1,000): 16.0 (2005); Gross primary enrollment (percent net): 84 (2005)

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

1/ Policies assumed here include: (i) exchange rate flexibility as from 2008; (ii) convergence of natural gas import prices to Western European levels (adjusted for transit) by 2010; (iii) public-financed recapitalization of banks for a total amount of Hrv 24 bln.

2/ The public finance aggregates cover the whole of the general government sector, including local authorities and the social funds. Reported fiscal outturns are adjusted to ensure consistency with international accounting rules. The 2010 projection includes the measures and structural reforms agreed under the program.

3/ The fiscal target under the original program (excludes the operational balance of Naftogaz).

4/ Starting with the second review, a new fiscal target was added under the program that ncludes the operational balance of Naftogaz.

5/ Government and government-guaranteed debt, and National bank of Ukraine debt. Excludes debt by state-owned enterprises.

Table 2. Ukraine: Selected Vulnerability Indicators, 2004–09

	2004	2005	2006	2007	2008	2009	Latest observation
Financial market indicators							
Short-term interest rate (percent) 1/	6.3	4.2	3.6	2.3	13.7	2.3	17-Jul-09
EMBI secondary market spread (basis points, end of period)	255	184	172	303	2,771	1,149	17-Jul-09
Foreign currency debt rating 2/	B1	B1	B1	B1	B1	B2	12-May-09
Exchange rate (hryvnia per U.S. dollar, end of period)	5.3	5.1	5.1	5.1	7.7	7.6	17-Jul-09
Stock market index (PFTS)	259.9	353.0	498.9	1,174.0	301.4	382.4	17-Jul-09
Broad money to gross reserves (percent)	248.2	196.1	232.8	242.5	302.6	230.1	17-Jul-09
External sector							
Exchange rate regime	de facto peg to U.S. dollar				managed float		
Current account balance (percent of GDP)	10.6	2.9	-1.5	-3.7	-7.2	0.6	Proj.
Net FDI inflows (percent of GDP)	2.6	8.7	5.3	6.4	5.5	3.4	Proj.
Exports of goods and nonfactor services (percent change of U.S. dollar value)	42.6	7.5	13.2	27.4	33.8	-30.8	Proj.
Real effective exchange rate (percent change) 3/	-1.4	12.0	4.8	2.6	12.6	-14.3	Proj.
Gross international reserves (billions of U.S. dollars)	9.5	19.4	22.3	32.4	31.5	30.0	Proj.
Percent of short-term debt at remaining maturity	87.4	161.0	108.6	115.4	89.6	89.6	Proj.
Percent of short-term debt at remaining maturity and banks' FX deposits	57.3	92.0	79.0	84.7	64.9	58.6	Proj.
Net international reserves (billions of U.S. dollars)	8.0	18.2	21.4	32.0	26.8	15.1	Proj.
Total gross external debt (perrcent of GDP) 4/	46.3	45.1	49.7	54.0	54.5	85.4	Proj.
Of which: short-term external debt (original maturity, percent of total external debt)	35.0	28.2	28.4	26.7	20.7	16.6	Proj.
External debt of domestic private sector (percent of total external debt)	57.2	65.2	72.3	79.8	80.7	70.9	Proj.
External debt to foreign official sector (percent of total external debt)	18.2	16.1	11.0	7.8	6.3	7.5	Proj.
Domestically issued public debt held by nonresidents (percent of GDP)	0.6	1.5	0.6	0.6	0.3	0.6	Proj.
Total gross external debt (percent of exports of goods and nonfactor services)	72.8	87.5	106.8	120.8	114.3	167.3	Proj.
Public Sector 5/							
Overall balance excluding bank recapitalization costs (percer	-4.4	-2.3	-1.4	-2.0	-3.2	-6.0	Proj.
Primary balance (percent of GDP)	4.3	3.8	4.2	3.9	4.3	4.1	Proj.
Debt-stabilizing primary balance (percent of GDP) 6/	-5.9	-5.4	-3.1	-3.4	-2.3	10.1	Proj.
Gross public sector financing requirement (percent of GDP) 7	2.8	1.0	0.4	1.5	2.9	3.8	Proj.
Public sector gross debt (percent of GDP) 8/	25.5	18.7	15.7	12.9	19.9	35.4	Proj.
Public sector net debt (percent of GDP)	23.3	13.9	11.7	10.1	10.6	17.0	Proj.

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

1/ Overnight interbank rate. Monthly average for December or month of latest observation.

2/ Moody's Investors Service.

3/ Period averages; (+) represents real appreciation; based on CPI and INS trade weights (1999-2001).

4/ June 2006 private sector debt is estimated.

5/ Public sector covers the consolidated government. It excludes public enterprises. Public debt also includes arrears and debt by the

6/ Does not include domestically issued public debt held by nonresidents.

7/ Overall balance plus debt amortization. Excludes bank recapitalization costs.

8/ Public debt figures exclude IMF money.

Table 3. Ukraine: Medium-Term Balance of Payments, 2007–14 1/ 2/ 3/ 4/

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

	2007	2008	2009	2009	2010	2011	2012	2013	2014
			1st Review			Proj.			
Current account balance	-5,272	-12,933	595	710	103	-2,097	-2,581	-4,141	-5,666
Merchandise trade balance	-10,572	-16,934	-3,311	-2,718	-4,314	-5,800	-6,750	-8,315	-9,436
Exports	49,840	67,717	48,198	45,216	49,480	54,196	59,127	63,887	69,148
Imports	-60,412	-84,651	-51,509	-47,934	-53,794	-59,996	-65,877	-72,202	-78,584
Services (net)	2,420	2,414	2,968	3,280	4,402	4,763	6,223	6,460	6,706
Receipts 2/	14,161	17,895	14,664	14,066	15,613	16,619	18,648	19,552	20,562
Payments	-11,741	-15,481	-11,696	-10,786	-11,211	-11,856	-12,425	-13,092	-13,856
Income (net)	-659	-1,540	-2,329	-2,802	-3,047	-4,313	-5,555	-6,069	-7,038
Of which: interest on public debt 3/	-1,019	-1,134	-1,554	-1,298	-1,502	-1,571	-1,593	-1,465	-1,293
Current transfers (net)	3,539	3,127	3,266	2,949	3,061	3,254	3,502	3,783	4,101
Financial and capital account	15,130	9,197	-12,904	-11,915	-1,425	2,867	8,072	10,291	11,960
Direct investment and capital transfers (net)	9,221	9,908	5,200	4,070	4,579	5,820	6,494	7,152	7,746
Portfolio investment (excluding government bonds)	4,423	-954	320	-80	420	1,020	2,220	2,920	2,920
Bonds and medium and long-term loans (net)	15,763	14,405	-5,568	-2,130	3,239	3,183	4,527	4,716	5,901
Private sector loans	13,931	14,481	-8,257	-3,703	1,297	2,297	3,097	3,897	3,897
Bonds and loans (official)	1,832	-76	2,689	1,572	1,942	886	1,429	818	2,004
Of which: disbursements	4,244	2,926	4,548	4,560	3,021	2,268	2,232	2,605	2,711
Repayments 2/ 3/	-2,412	-3,002	-1,858	-2,988	-1,080	-1,382	-802	-1,787	-707
Of which: foreign currency	1,654	185	2,542	1,506	1,770	608	1,152	543	1,732
Domestic currency	178	-261	148	66	171	278	277	275	271
Short-term capital (net)	-14,277	-14,162	-12,856	-13,775	-9,663	-7,157	-5,169	-4,496	-4,606
Errors and omissions	-437	528	0	469	0	0	0	0	0
Overall balance	9,421	-3,208	-12,309	-10,736	-1,322	770	5,491	6,150	6,294
Available financing	9,421	-3,208	-12,309	-10,736	-1,322	770	5,491	6,150	6,294
Gross official reserves (- is increase)	-8,980	-1,080	2,232	659	-1,024	-770	-1,996	1,719	-1,186
Net use of IMF resources	-441	4,347	10,077	10,077	2,346	0	-3,495	-7,869	-5,108
Memorandum items:									
Total external debt 3/	77,331	97,852	99,294	99,162	102,943	105,754	107,327	105,266	107,282
Total external debt (percent of GDP)	54.0	54.5	87.0	85.4	85.3	80.5	73.1	65.0	60.3
Current account (percent of GDP)	-3.7	-7.2	0.5	0.6	0.1	-1.6	-1.8	-2.6	-3.2
Excluding transfers	-6.2	-8.9	-2.3	-1.9	-2.5	-4.1	-4.1	-4.9	-5.5
Debt service ratio (percent of exports of goods and services) 2/ 3/	4.0	2.7	5.6	7.1	4.0	4.2	7.6	13.3	7.9
Gross international reserves (end of period) 4/	32,436	31,543	29,311	30,000	31,024	31,794	33,790	32,071	33,257
Months of next year's imports of goods and services	3.9	6.4	5.3	5.5	5.2	4.9	4.8	4.2	...
Over next year's official debt service	7.3	7.2	9.8	11.6	10.5	5.4	3.0	4.5	...
Merchandise export values (percent change)	28.0	35.9	-28.8	-33.2	9.4	9.5	9.1	8.1	8.2
Merchandise import values (percent change)	36.9	40.1	-39.2	-43.4	12.2	11.5	9.8	9.6	8.8
Merchandise export volume (percent change)	3.2	-1.9	-8.8	-13.6	6.1	6.7	6.3	5.4	5.9
Merchandise import volume (percent change)	20.3	16.8	-31.8	-36.4	6.6	6.2	6.9	7.2	6.6
Goods terms of trade (percent change)	9.0	8.0	-13.6	-13.6	-2.1	-2.4	-0.1	0.3	0.1
Goods and services terms of trade (percent change)	7.4	8.8	-9.2	-9.1	2.2	-0.9	0.6	0.9	0.4

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

1/ Recommended policies include increased flexibility of the hryvnia/U.S. dollar exchange rate, which would hold gross international reserves above 3 months of imports.

2/ Includes lease receipts and offsetting repayments under the Black Sea Fleet debt swap agreement.

3/ Public and publicly guaranteed debt, on a residency basis.

4/ Does not include Ukraine's share of the proposed general and special SDR allocations ($ 2 b.).

Table 4. Ukraine: General Government Finances, 2008–10 1/ 2/

	2008		2009		2009		2010		2010	
	Est.		1st Review		Proj.				Proj. (with measures)	
	General Government	State	General Government	State	General Government	State	General Government	State	General Government	State
	(Billions of Ukrainian hryvnia)									
Revenue	**419.7**	**231.7**	**410.0**	**230.0**	**379.3**	**211.4**	**442.2**	**246.7**	**445.7**	**249.2**
Tax revenue	358.1	187.5	352.0	186.4	319.4	166.1	371.9	193.4	375.4	195.9
Personal income tax	45.9	0.0	46.7	0.0	42.1	0.0	49.1	0.0	49.1	0.0
Enterprise profit tax	47.9	47.5	41.1	40.6	36.4	36.0	42.4	41.9	43.4	42.9
Payroll tax	107.9	0.0	99.1	0.0	98.6	0.0	114.8	0.0	114.8	0.0
Property tax	6.7	0.0	6.1	0.0	5.7	0.0	6.7	0.0	6.7	0.0
VAT	92.1	92.1	90.9	90.9	80.9	80.9	94.2	94.2	95.2	95.2
Other taxes on goods and services	28.7	25.4	40.3	34.6	36.5	34.1	42.5	39.7	44.0	40.2
Taxes on international trade	12.3	12.3	10.8	10.8	6.5	6.5	7.5	7.5	7.5	7.5
Other taxes	16.7	10.3	17.0	9.4	12.6	8.6	14.6	10.0	14.6	10.0
Nontax, capital revenue, and grants	61.6	44.1	58.0	43.6	59.9	45.3	70.3	53.3	70.3	53.3
Expenditure	**449.6**	**256.0**	**455.0**	**275.0**	**436.0**	**268.1**	**494.7**	**299.0**	**482.2**	**285.5**
Current expenditures	392.5	215.9	404.8	234.2	392.6	229.8	442.6	257.4	430.1	243.9
Wages	97.7	43.4	104.8	46.0	101.8	46.0	112.3	50.7	107.3	47.7
Goods and services	59.5	38.5	60.5	42.8	60.7	41.2	68.0	45.2	65.0	42.2
Subsidies	34.4	24.8	20.3	10.3	19.5	10.3	22.5	11.9	22.5	11.9
Transfers	196.0	104.7	202.5	118.9	196.7	118.9	221.5	131.2	217.0	123.7
Interest	4.9	4.4	16.8	16.2	13.8	13.4	18.3	18.3	18.3	18.3
Of which: related to bank recapitalization bonds	0.0	0.0	5.0	5.0	1.7	1.7	5.0	5.0	5.0	5.0
Capital spending	52.9	37.4	44.3	35.0	37.6	32.4	47.8	36.9	47.8	36.9
Net lending	2.8	2.7	5.9	5.8	5.9	5.8	4.3	4.7	4.3	4.7
Unallocated spending	1.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance 3/	-30.0	-24.3	-40.0	-40.0	-55.0	-55.0	-47.6	-47.4	-31.6	-31.4
Naftogaz operational balance (before measures) 4/	0.0	0.0	-18.1	-18.1	-25.0	-25.0	-20.7	-20.7	-10.7	-10.7
Naftogaz operational balance (after measures) 4/	0.0	0.0	-18.1	-18.1	-24.1	-24.1	-10.7	-10.7	-10.7	-10.7
Overall balance (including Naftogaz) 5/	**-30.0**	**-24.3**	**-58.1**	**-58.1**	**-79.1**	**-79.1**	**-58.3**	**-58.1**	**-42.3**	**-42.1**
Bank recapitalization costs 6/	0.0	0.0	-49.0	-49.0	-25.7	-25.7	-25.0	-25.0	-25.0	-25.0
Of which: bank recapitalization bonds	0.0	0.0	-44.0	-44.0	-24.0	-24.0	-20.0	-20.0	-20.0	-20.0
Overall balance (including Naftogaz and bank recapitalization costs	-30.0	-24.3	-107.1	-107.1	-104.8	-104.8	-83.2	-83.1	-67.2	-67.1
Overall balance (exluding bank recapitalization bonds)	-30.0	-24.3	-63.1	-63.1	-80.8	-80.8	-63.2	-63.1	-47.2	-47.1
Financing (excluding bank recap bonds)	30.0	24.3	63.1	63.1	80.8	80.8	63.2	63.1	47.2	47.1
External	3.6	3.7	31.3	31.3	23.4	23.4	8.3	8.3	8.3	8.3
Disbursements	6.2	6.0	47.6	47.6	43.4	43.4	24.9	24.9	24.9	24.9
Amortization	-2.6	-2.4	-16.4	-16.4	-20.0	-20.0	-16.7	-16.7	-16.7	-16.7
Domestic	23.9	20.1	24.4	26.4	54.9	56.9	50.9	52.8	34.9	36.8
Net Borrowing	20.0	20.0	2.2	2.2	-8.1	-8.1	50.9	52.8	34.9	36.8
Borrowing	23.4	23.4	16.7	16.7	16.7	16.7	81.4	83.3	65.4	67.3
Amortization	-3.4	-3.4	-14.5	-14.5	-24.8	-24.8	-30.5	-30.5	-30.5	-30.5
Other, including deposit finance	3.9	0.1	22.2	24.2	63.0	65.0	0.0	0.0	0.0	0.0
Privatization	2.5	0.5	2.5	0.5	2.5	0.5	4.0	2.0	4.0	2.0

Table 4. Ukraine: General Government Finances, 2008–10 1/ 2/ (concluded)

	2008 Est.		2009 1st Review		2009 Proj.		2010 Proj.		2010 Proj. (with measures)	
	General Government	State	General Government	State	General Government	State	General Government	State	General Government	State
	(Percent of GDP, unless otherwise indicated)									
Revenue	**44.2**	**24.4**	**41.4**	**23.2**	**41.4**	**23.1**	**41.9**	**23.3**	**42.2**	**23.6**
Tax revenue	37.7	19.7	35.6	18.8	34.9	18.1	35.2	18.3	35.5	18.5
Personal income tax	4.8	0.0	4.7	0.0	4.6	0.0	4.6	0.0	4.6	0.0
Enterprise profit tax	5.0	5.0	4.1	4.1	4.0	3.9	4.0	4.0	4.1	4.1
Payroll tax	11.4	0.0	10.0	0.0	10.8	0.0	10.9	0.0	10.9	0.0
Property tax	0.7	0.0	0.6	0.0	0.6	0.0	0.6	0.0	0.6	0.0
VAT	9.7	9.7	9.2	9.2	8.8	8.8	8.9	8.9	9.0	9.0
Other taxes on goods and services	3.0	2.7	4.1	3.5	4.0	3.7	4.0	3.8	4.2	3.8
Taxes on international trade	1.3	1.3	1.1	1.1	0.7	0.7	0.7	0.7	0.7	0.7
Other taxes	1.8	1.1	1.7	1.0	1.4	0.9	1.4	0.9	1.4	0.9
Nontax, capital revenue, and grants	6.5	4.6	5.9	4.4	6.5	4.9	6.7	5.0	6.7	5.0
Expenditure	**47.3**	**26.9**	**46.0**	**27.8**	**47.6**	**29.3**	**46.8**	**28.3**	**45.6**	**27.0**
Current expenditures	41.3	22.7	40.9	23.7	42.8	25.1	41.9	24.4	40.7	23.1
Wages	10.3	4.6	10.6	4.6	11.1	5.0	10.6	4.8	10.2	4.5
Goods and services	6.3	4.1	6.1	4.3	6.6	4.5	6.4	4.3	6.2	4.0
Subsidies	3.6	2.6	2.0	1.0	2.1	1.1	2.1	1.1	2.1	1.1
Transfers	20.6	11.0	20.5	12.0	21.5	13.0	21.0	12.4	20.5	11.7
Interest	0.5	0.5	1.7	1.6	1.5	1.5	1.7	1.7	1.7	1.7
Of which: related to bank recapitalization bonds	0.0	0.0	0.5	0.5	0.2	0.2	0.5	0.5	0.5	0.5
Capital spending	5.6	3.9	4.5	3.5	4.1	3.5	4.5	3.5	4.5	3.5
Net lending	0.3	0.3	0.6	0.6	0.6	0.6	0.4	0.4	0.4	0.4
Unallocated spending	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance 3/	**-3.2**	**-2.6**	**-4.0**	**-4.0**	**-6.0**	**-6.0**	**-4.5**	**-4.5**	**-3.0**	**-3.0**
Naftogaz operational balance (before measures) 4/	0.0	0.0	-1.8	-1.8	-2.7	-2.7	-2.0	-2.0	-1.0	-1.0
Naftogaz operational balance (after measures) 4/	0.0	0.0	-1.8	-1.8	-2.6	-2.6	-1.0	-1.0	-1.0	-1.0
Overall balance (including Naftogaz) 5/	**-3.2**	**-2.6**	**-5.9**	**-5.9**	**-8.6**	**-8.6**	**-5.5**	**-5.5**	**-4.0**	**-4.0**
Bank recapitalization costs 6/	0.0	0.0	-4.9	-4.9	-2.8	-2.8	-2.4	-2.4	-2.4	-2.4
Of which: bank recapitalization bonds	0.0	0.0	-4.4	-4.4	-2.6	-2.6	-1.9	-1.9	-1.9	-1.9
Overall balance (including Naftogaz and bank recapitalization costs	-3.2	-2.6	-10.8	-10.8	-11.4	-11.4	-7.9	-7.9	-6.4	-6.3
Overall balance (exluding bank recapitalization bonds)	-3.2	-2.6	-6.4	-6.4	-8.8	-8.8	-6.0	-6.0	-4.5	-4.5
Financing (excluding bank recap bonds)	3.2	2.6	6.4	6.4	8.8	8.8	6.0	6.0	4.5	4.5
External	0.4	0.4	3.2	3.2	2.6	2.6	0.8	0.8	0.8	0.8
Disbursements	0.7	0.6	4.8	4.8	4.7	4.7	2.4	2.4	2.4	2.4
Amortization	-0.3	-0.2	-1.7	-1.7	-2.2	-2.2	-1.6	-1.6	-1.6	-1.6
Domestic	2.5	2.1	2.5	2.7	6.0	6.2	4.8	5.0	3.3	3.5
Net Borrowing	2.1	2.1	0.2	0.2	-0.9	-0.9	4.8	5.0	3.3	3.5
Borrowing	2.5	2.5	1.7	1.7	1.8	1.8	7.7	7.9	6.2	6.4
Amortization	-0.4	-0.4	-1.5	-1.5	-2.7	-2.7	-2.9	-2.9	-2.9	-2.9
Other, including deposit finance	0.4	0.0	2.2	2.4	6.9	7.1	0.0	0.0	0.0	0.0
Privatization	0.3	0.1	0.3	0.1	0.3	0.1	0.4	0.2	0.4	0.2
Financing gap	0.0	0.0	0.5	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum item:										
Output gap	6.9	6.9	-1.6	-1.6	-5.6	-5.6	-4.6	-4.6	-4.6	-4.6
Structural balance 7/	-1.3	-1.3	-4.8	-4.8	-6.7	-6.7	-5.7	-5.7	-4.2	-4.2
Cyclically-adjusted structural balance 8/	-4.4	-4.4	-4.1	-4.1	-4.1	-4.1	-3.6	-3.6	-2.1	-2.1
Nominal GDP (billions of hryvnias)	949.9	949.9	989.7	989.7	916.2	916.2	1,056.4	1,056.4	1,056	1,056

Sources: Ministry of Finance; NBU; and IMF staff estimates and projections.

1/ The general government covers the whole of the central government, local governments, the pension fund, and other social funds. The differences between staff's and the authorities' public finances numbers and projections also reflect accounting treatments to ensure consistency with international accounting rules.

2/ State revenue are adjusted for the non-cash property income paid by Russia in exchange for amortization of Ukraine's debt to Russia.

3/ The original fiscal target under the program (excluding bank recap costs and opertaional balance of Naftogaz).

4/ The operational balance of Naftogaz is based on the 2009 financial plan of the company. It reflects the losses of the company, after budget transfers, due to underpriced domestic gas sales and other quasi-fiscal operations. The measures include a one-time gas price adjustment in 2009 and quarterly adjustments in 2010.

5/ An additional fiscal target was introduced under the program that includes the operational balance of Naftogaz (starting with the second review).

6/ The bank recapitalization program assumes issuance of bank recapitalization bonds of 24 billion hryvnia in 2009 and 20 billion hryvnia in 2010.

7/ The structural balance excludes bank recapitalization bonds and one-off sales of carbon emission rights to Japan (0.3 percent of GDP both in 2009 and 2010).

8/ The cyclically-adjusted structural balance adjusts the structural balance for the effect of the cycle.

Table 5. Ukraine: Monetary Accounts, 2005–10 1/

	2005	2006	2007	2008	2009	2009	2010
					1st Review	Proj.	
				(Millions of hryvnias)			
Monetary Survey							
Net foreign assets	81,842	66,717	50,978	-32,332	-116,476	-38,342	-3,029
Net domestic assets	112,229	194,346	345,179	548,059	651,618	561,833	601,872
Domestic credit	144,892	247,037	436,285	776,162	889,130	821,589	886,101
Net claims on government	-7,180	-7,821	-6,658	22,274	76,253	44,028	89,106
Credit to the economy	144,277	246,156	428,347	737,273	794,962	760,424	779,430
Other claims on the economy	7,796	8,702	14,597	16,615	17,915	17,137	17,565
Other items, net	-32,663	-52,691	-91,107	-228,103	-237,512	-259,756	-284,229
Broad money	194,071	261,063	396,156	515,727	535,142	523,490	598,843
Currency in circulation	60,231	74,984	111,119	154,759	161,702	168,762	162,155
Total deposits	132,914	184,430	280,154	357,768	370,119	351,480	432,972
Domestic currency deposits	87,296	114,274	190,287	200,257	190,295	198,172	232,869
Foreign currency deposits	45,617	70,155	89,867	157,512	179,824	153,307	200,102
Money market instruments	925	1,650	4,884	3,200	3,321	3,248	3,716
Accounts of the National Bank of Ukraine							
Net foreign assets	94,016	110,916	164,859	193,783	124,254	184,024	241,623
Net domestic assets	-11,256	-13,702	-22,958	-7,113	74,645	21,521	-16,348
Net domestic credit	-10,266	-8,127	-7,856	69,023	165,826	95,943	68,098
Net claims on government	-8,149	-8,949	-6,274	10,754	60,564	17,482	23,732
Claims on government	10,315	9,676	9,058	23,674	64,418	26,418	31,418
Liabilities government	18,464	18,625	15,332	12,920	3,854	8,936	7,686
Net claims on the economy	76	169	165	379	379	379	379
Net claims on banks	-2,193	653	-1,748	57,890	104,883	78,083	43,987
Other items, net	-991	-5,575	-15,102	-76,136	-91,181	-74,422	-84,446
Base money	82,760	97,214	141,901	186,671	198,899	205,545	225,275
Currency in circulation	60,231	74,984	111,119	154,759	161,702	168,762	162,155
Banks' reserves	22,528	22,231	30,782	31,912	37,197	36,783	63,120
Cash in vault	5,178	7,150	11,352	12,779	12,617	11,931	20,709
Required reserves	9,853	4,080	9,683	13,672	17,474	16,745	23,427
Excess reserves	7,498	11,001	9,748	5,461	7,106	8,106	18,985
Deposit Money Banks							
Net foreign assets	-12,175	-44,199	-113,882	-226,116	-240,731	-222,366	-244,653
Net domestic assets	144,919	228,433	393,620	583,320	610,850	573,846	677,625
Domestic credit	169,322	268,275	459,600	721,701	757,486	760,191	879,953
Net claims on government	969	1,128	-384	11,520	15,689	26,546	65,374
Credit to the economy	144,129	245,973	428,146	736,840	794,529	759,991	778,997
Other claims on the economy	7,796	8,702	14,597	16,615	14,954	14,954	16,449
Banks' reserves	22,528	22,231	30,782	31,912	37,197	36,783	63,120
Other items, net	-24,402	-39,842	-65,981	-138,381	-146,636	-186,345	-202,329
Banks' liabilities	132,745	184,234	279,738	357,204	370,119	351,480	432,972
Demand deposits	48,115	61,136	90,364	104,807	...	...	...
Time deposits	84,629	123,098	189,374	252,397	...	...	...
Memorandum items:				(Year-on-year percent change)			
Base money	53.9	17.5	46.0	31.6	6.6	10.1	9.6
Broad money	54.4	34.5	51.7	30.2	3.8	1.5	14.4
Credit to the economy	61.8	70.6	74.0	72.1	7.8	3.1	2.5
				(Ratio)			
Velocity of broad money 3/	2.27	2.08	1.80	1.84	1.85	1.75	1.76
Money multiplier	2.34	2.69	2.79	2.76	2.69	2.55	2.66
				(Percent)			
Foreign currency loans to total loans	43.2	49.4	49.8	58.9	44.7	39.8	41.3
Foreign currency deposits to total deposits	34.3	38.0	32.1	44.0	48.6	43.6	46.2

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

1/ Program scenario. See policy assumptions in footnote 1 of Selected economic Indicators Table.
2/ Projected net international reserves are at projected exchange rates.
3/ Based on nominal GDP over the last four quarters.

Table 6. Ukraine: Financial Soundness Indicators for the Banking Sector, 2007–09

(Percent, unless otherwise indicated)

	2007				2008				2009	
	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.
Ownership										
Number of banks 1/	173	173	174	175	176	178	184	184	185	187
Private	171	171	172	173	174	176	182	182	183	185
Domestic	131	129	128	126	127	127	132	132	131	134
Foreign	40	42	44	47	47	49	50	50	52	51
Of which: 100% foreign-owned	18	17	16	17	17	18	18	18	17	17
State-owned	2	2	2	2	2	2	2	2	2	2
Foreign-owned banks' share in statutory capital	29.8	32.8	35.0	35.0	36.7	40.5	39.8	36.7	37.6	39.1
Concentration										
Share of assets of largest 10 banks	53.0	52.5	51.6	49.7	49.8	49.4	49.0	52.0	53.0	53.2
Share of assets of largest 25 banks	74.6	75.4	75.2	75.2	75.0	74.9	74.7	76.4	76.5	76.1
Number of bank with assets less than $150 million	113	100	97	85	86	83	81	81	106	109
Capital Adequacy										
Regulatory capital to risk-weighted assets	14.0	14.0	13.9	13.9	13.3	13.4	13.6	14.0	15.4	14.5
Capital to total assets	12.9	12.4	12.5	12.5	13.1	12.9	13.0	14.0	13.1	…
Asset Quality										
Credit growth (year-over-year)	73.0	75.6	75.1	74.1	76.2	64.1	54.1	23.5	-1.0	…
Credit to GDP ratio	47.7	51.6	55.6	60.1	62.7	60.8	63.1	83.0	74.7	…
Change of loan to GDP ratio (percentage points)	13.3	14.3	14.6	14.9	15.0	9.2	7.5	23.0	12.0	…
NPLs to total loans 2/	17.6	16.5	14.8	13.2	13.1	13.6	14.5	17.4	24.0	29.9
NPLs (excl. part of timely serviced substandard loans) 2/	4.2	3.7	3.3	3.2	3.2	3.7	3.6	4.6	7.5	…
NPLs net of provisions to capital	99.1	94.2	82.2	72.9	70.6	74.4	78.1	90.4	…	…
Specific provisions to NPLs	20.8	23.7	25.9	26.3	26.7	26.3	26.0	29.6	29.3	29.8
Specific provisions to total loans	4.7	4.7	4.5	4.2	4.1	4.1	4.3	6.1	8.6	10.8
Foreign Exchange Rate Risk										
Loans in foreign currency to total loans	50.8	51.2	51.5	49.8	49.4	49.3	51.2	58.9	56.5	…
Deposits in foreign currency to total deposits	38.8	36.5	34.6	32.1	33.1	32.5	31.8	44.0	44.4	…
Foreign currency loans to foreign currency deposits	183.7	206.0	220.8	237.2	238.8	245.5	269.2	275.5	292.2	…
Total net open positions in foreign currency to regulatory capital	9.3	9.1	8.7	7.0	7.7	7.7	7.1	10.4	12.2	…
Liquidity Risk										
Liquid assets to total assets	11.4	11.8	11.0	10.3	8.9	9.2	8.9	8.2	7.9	9.0
Customer deposits to total loans to the economy	71.2	67.9	67.2	65.3	62.4	61.8	59.8	48.5	43.6	...
Earnings and Profitability										
Return on assets (after tax; end-of-period)	1.6	1.4	1.4	1.5	1.4	1.3	1.3	1.0	-3.2	-3.3
Return on equity (after tax; end-of-period)	12.7	11.3	11.6	12.7	11.4	11.2	10.9	8.5	-23.4	-24.5
Net interest margin to total assets	4.9	4.9	4.9	5.0	4.8	5.0	5.2	5.3	6.6	6.3
Interest rate spreads (percentage points; end-of-period)										
Between loans and deposits in domestic currency	5.9	6.5	5.4	5.8	6.3	7.6	7.1	8.6	11.3	4.3
Between loans and deposits in foreign currency	5.6	5.5	5.5	4.9	5.2	8.3	6.3	4.4	3.0	0.3
Between loans in domestic and foreign currency	2.5	3.0	2.7	3.2	4.4	5.3	4.2	9.0	15.6	6.9
Between deposits in domestic and foreign currency	2.2	1.9	2.8	2.3	3.3	6.0	3.4	4.9	7.3	2.9
Number of banks not complying with banking regulations										
Not meeting capital adequacy requirements for Tier I capital	0	0	1	0	0	0	0	4	8	13
Not meeting prudential regulations	0	1	1	1	2	1	2	13	23	34
Not meeting reserve requirements	0	0	0	1	0	0	0	…	…	…

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

1/ The recent increase in the number of banks reflects the granting of bank licenses that had been in the pipeline.

2/ NPLs are those classified as substandard, doubtful, and loss.

Table 7. Medium-term Macroeconomic Framework, 2005–14 1/

	2005	2006	2007	2008	2009	2009	2010	2011	2012	2013	2014
				Est.	1st Review			Proj. 1/			
Output and prices											
Nominal GDP (billions of hryvnias)	441	544	721	950	990	916	1056	1182	1325	1472	1639
Real GDP growth (percent change)	2.7	7.3	7.9	2.1	-8.0	-14.0	2.7	4.4	5.1	5.4	5.8
Real domestic demand growth (percent change)	15.3	13.8	16.5	8.0	-18.8	-24.8	4.0	4.9	5.4	6.6	6.4
Consumer prices (percent change; end of period)	10.3	11.6	16.6	22.3	16.0	14.0	9.0	6.0	5.0	5.0	5.0
Consumer prices (percent change; average)	13.5	9.1	12.8	25.2	17.2	16.3	10.3	7.5	5.5	5.0	5.0
Wages											
Minimum wage (percent change; average)	39.3	21.4	17.9	23.8	18.1	18.1	12.5	12.0	11.0	10.5	10.5
Nominal monthly wages (average)	36.7	29.2	29.7	33.7	4.0	3.5	9.0	10.5	10.0	10.0	10.5
Real monthly wages (average)	20.5	18.4	15.0	6.8	-11.2	-11.0	-1.2	2.8	4.2	4.8	5.2
Public finances (percent of GDP) 2/											
General government balance 3/	-2.3	-1.4	-2.0	-3.2	-4.0	-6.0	-3.0	-3.0	-1.8	-1.0	-1.0
Overall balance (including Naftogaz and bank recapitalization c	-2.3	-1.4	-2.0	-3.2	-10.8	-11.4	-6.4	-3.0	-1.8	-1.0	-1.0
Overall balance (including Naftogaz operational deficit) 4/	-2.3	-1.4	-2.0	-3.2	-5.9	-8.6	-4.0	-3.0	-1.8	-1.0	-1.0
Revenue and grants	41.8	43.7	41.8	44.2	41.4	41.4	41.9	42.7	43.1	43.5	43.5
Expenditure and net lending (cash basis)	44.1	45.1	43.8	47.3	45.5	47.4	46.4	45.7	44.9	44.5	44.5
Privatization receipts	5.0	0.4	0.6	0.3	0.3	0.3	0.4	0.2	0.2	0.2	0.2
Net domestic financing	-3.3	-0.3	0.4	2.5	7.4	8.6	5.2	2.1	0.9	0.2	0.1
Net external financing	0.6	1.3	1.0	0.4	3.2	2.6	0.8	0.7	0.7	0.7	0.7
Public debt (end of period) 5/	18.7	15.7	12.9	19.9	32.5	35.4	38.6	38.3	36.6	34.6	32.6
Domestic	4.6	3.3	2.8	4.9	9.4	6.8	12.6	13.8	13.7	12.8	11.9
External (foreign currency denominated)	14.1	12.5	10.1	15.0	23.1	25.0	23.8	21.8	20.0	18.6	17.6
Money and credit											
Base money (percent change, end of period)	53.9	17.5	46.0	31.6	6.6	10.1	9.6	7.9	12.4	11.2	10.7
Credit to nongovernment (percent change, end of period)	61.8	70.6	74.0	72.1	7.8	3.1	2.5	11.1	12.3	13.8	10.9
Share of fx credit in total credit	43.2	49.4	49.8	58.9	44.7	39.8	41.3	41.8	42.3	42.1	43.5
External sector											
Current account balance (percent of GDP)	2.9	-1.5	-3.7	-7.2	0.5	0.6	0.1	-1.6	-1.8	-2.6	-3.2
Total external debt (percent of GDP)	45.1	49.7	54.0	54.5	87.0	85.4	85.3	80.5	73.1	65.0	60.3
Goods exports, value (percent change)	4.8	11.2	28.0	35.9	-28.8	-33.2	9.4	9.5	9.1	8.1	8.2
Goods imports, value (percent change)	21.8	22.1	36.9	40.1	-39.2	-43.4	12.2	11.5	9.8	9.6	8.8
Foreign direct investment (percent of GDP)	8.7	5.3	6.4	5.5	4.6	3.4	3.8	4.4	4.4	4.4	4.4
Gross official reserves (end of period)											
Billions of U.S. dollars	19.4	22.3	32.4	31.5	29.3	30.0	31.0	31.8	33.8	32.1	33.3
Months of imports of goods and services	4.4	3.7	3.9	6.4	5.3	5.5	5.2	4.9	4.8	4.2	…
External debt service (percent of exports of goods and services	4.9	5.1	4.0	2.7	5.6	7.1	4.0	4.2	7.6	13.3	7.9
Hryvnia per U.S. dollar (end of period)	5.1	5.1	5.1	7.7	…	…	…	…	…	…	…
Goods terms of trade (percent change)	6.1	-0.3	9.0	8.0	-13.6	-13.6	-2.1	-2.4	-0.1	0.3	0.1
Goods and services terms of trade (percent change)	4.9	1.5	7.4	8.8	-9.2	-9.1	2.2	-0.9	0.6	0.9	0.4
Savings-investment balance (percent of GDP)											
Foreign savings	-2.9	1.5	3.7	7.2	-0.5	-0.7	-0.2	1.4	1.9	2.7	3.3
Gross national savings	25.6	23.3	24.5	21.6	26.6	24.1	24.5	23.6	23.8	24.6	24.2
Nongovernment	25.8	22.4	23.9	22.3	30.0	30.1	29.6	28.1	27.6	27.3	27.4
Government	-0.3	0.9	0.7	-0.7	-3.4	-6.0	-5.1	-4.5	-3.9	-2.7	-3.2
Gross investment	22.6	24.8	28.2	28.8	26.1	23.4	24.3	25.1	25.6	27.2	27.5
Nongovernment	20.6	22.5	25.6	26.4	24.9	22.1	22.0	22.3	22.8	24.9	25.4
Government	2.0	2.2	2.6	2.5	1.2	1.3	2.3	2.8	2.8	2.3	2.1

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

1/ Policies assumed here include: (i) increased exchange rate flexibility as from 2008; (ii) convergence of natural gas import prices to Western European levels (adjusted for transit) by 2010; (iii) full pass-through of rising energy import prices in 2009; (iv) public-financed recapitalization of banks for a total amount of 24 billion hryvnias.

2/ The public finance aggregates cover the whole of the general government sector, including local authorities and the social funds. Reported fiscal outturns are adjusted to ensure consistency with international accounting rules. The 2010 projection includes the measures and structural reforms agreed under the program.

3/ The fiscal target under the original program (excludes the operational balance of Naftogaz).

4/ Starting with the second review, a new fiscal target was added under the program that ncludes the operational balance of Naftogaz.

5/ Government and government-guaranteed debt, and National bank of Ukraine debt. Excludes debt by state-owned enterprises.

Table 8. Ukraine: Public Sector Debt Sustainability Framework, 2004–14

(Percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing primary balance 9/
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	
Baseline: public sector debt 1/	25.5	18.7	15.7	12.9	19.9	35.4	38.6	38.3	36.6	34.6	32.6	-0.9
Of which: foreign-currency denominated	19.2	14.1	12.5	10.1	15.0	25.0	23.8	21.8	20.0	18.6	17.6	
Change in public sector debt	-5.1	-6.9	-2.9	-2.9	7.1	15.5	3.2	-0.3	-1.7	-2.0	-2.0	
Identified debt-creating flows (4+7+12)	-5.6	-9.0	-2.3	-2.6	4.0	16.8	2.9	-0.5	-1.9	-2.2	-2.1	
Primary deficit	3.5	1.5	0.7	1.5	2.6	10.0	4.4	0.7	-0.4	-1.1	-1.0	
Revenue and grants	37.1	41.8	43.7	41.8	44.2	41.4	41.9	42.7	43.1	43.5	43.5	
Primary (noninterest) expenditure	40.6	43.3	44.5	43.3	46.8	51.4	46.3	43.3	42.7	42.4	42.5	
Automatic debt dynamics 2/	-6.0	-5.6	-2.7	-3.5	1.6	2.2	-1.2	-1.0	-1.3	-0.9	-1.0	
Contribution from interest rate/growth differential 3/	-6.0	-4.8	-2.7	-3.5	-2.6	2.2	-1.2	-1.0	-1.3	-0.9	-1.0	
Of which contribution from real interest rate	-3.1	-4.3	-1.6	-2.6	-2.4	-0.7	-0.4	0.5	0.4	0.8	0.8	
Of which contribution from real GDP growth	-2.9	-0.5	-1.1	-0.9	-0.2	2.9	-0.8	-1.5	-1.7	-1.8	-1.8	
Contribution from exchange rate depreciation 4/	-0.1	-0.7	0.0	0.0	4.2	...	...	...	...	...	...	
Other identified debt-creating flows	-3.1	-5.0	-0.4	-0.6	-0.3	4.5	-0.2	-0.2	-0.2	-0.2	-0.2	
Privatization receipts (negative)	-3.1	-5.0	-0.4	-0.6	-0.3	-0.3	-0.2	-0.2	-0.2	-0.2	-0.2	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	4.8	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	0.6	2.1	-0.6	-0.3	3.1	-1.4	0.2	0.2	0.2	0.2	0.2	
Public sector debt-to-revenue ratio 1/	68.8	44.6	36.0	30.8	45.1	85.5	92.2	89.7	85.0	79.5	74.9	
Gross financing need 6/	6.8	5.5	3.1	2.8	3.8	14.9	10.5	6.0	4.5	3.7	3.5	
Billions of U.S. dollars	4.4	4.7	3.3	4.0	6.8	17.3	12.7	7.9	6.6	6.0	6.2	
Scenario with key variables at their historical averages 7/						35.4	29.9	25.3	21.7	18.6	16.0	-2.8
Scenario with no policy change (constant primary balance) in 2009–14						35.4	44.3	53.3	61.6	70.1	78.4	-1.8
Key macroeconomic and fiscal assumptions underlying baseline												
Real GDP growth (percent)	12.1	2.7	7.1	7.9	2.1	-14.0	2.7	4.4	5.1	5.4	5.8	
Average nominal interest rate on public debt (percent) 8/	3.9	3.8	4.2	4.3	5.3	7.3	11.3	9.0	8.3	8.2	8.2	
Average real interest rate (nominal rate minus change in GDP deflator, percent)	-11.2	-20.8	-9.5	-19.9	-23.8	-4.9	-1.0	1.9	1.6	2.8	2.9	
Nominal appreciation (increase in US dollar value of local currency, percent)	0.5	5.1	0.0	0.0	-34.1	...	...	...	...	...	...	
Inflation rate (GDP deflator, percent)	15.2	24.6	13.7	24.2	29.1	12.2	12.3	7.1	6.7	5.4	5.3	
Growth of real primary spending (deflated by GDP deflator, percent)	20.2	9.6	9.9	5.0	10.4	-5.5	-7.7	-2.2	3.6	4.6	6.0	
Primary deficit	3.5	1.5	0.7	1.5	2.6	10.0	4.4	0.7	-0.4	-1.1	-1.0	

1/ The coverage of the public sector is the general government, and also includes Naftogaz starting from 2009.

2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = 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).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).

5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

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.

Table 9. Ukraine: External Debt Sustainability Framework, 2004–14

(Percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing non-interest current account 6/
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	
Baseline: external debt	46.3	45.1	49.7	54.0	54.5	85.4	85.3	80.5	73.1	65.0	60.3	-5.6
Change in external debt	-0.3	-1.2	4.6	4.3	0.5	30.9	-0.1	-4.7	-7.4	-8.1	-4.7	
Identified external debt-creating flows (4+8+9)	-27.1	-26.3	-16.3	-19.0	-8.6	9.0	-6.8	-7.2	-8.2	-7.1	-6.8	
Current account deficit, excluding interest payments	-11.9	-4.6	-0.8	2.2	5.4	-7.6	-6.9	-5.7	-5.7	-4.6	-3.7	
Deficit in balance of goods and services	-7.7	-0.8	2.8	5.7	8.1	-0.5	-0.1	0.8	0.4	1.1	1.5	
Exports	63.6	51.5	46.5	44.7	47.7	51.0	53.9	53.9	53.0	51.5	50.4	
Imports	56.0	50.7	49.4	50.4	55.8	50.6	53.8	54.7	53.3	52.6	51.9	
Net non-debt creating capital inflows (negative)	-5.8	-11.9	-8.6	-10.5	-4.8	-2.2	-4.5	-5.3	-6.3	-6.1	-6.5	
Automatic debt dynamics 1/	-9.3	-9.8	-6.8	-10.7	-9.1	18.8	4.6	3.9	3.8	3.6	3.5	
Contribution from nominal interest rate	1.3	1.6	2.3	1.5	1.8	7.0	6.8	7.3	7.5	7.1	6.9	
Contribution from real GDP growth	-4.4	-0.9	-2.6	-3.0	-0.9	11.8	-2.2	-3.5	-3.7	-3.6	-3.4	
Contribution from price and exchange rate changes 2/	-6.2	-10.5	-6.5	-9.2	-10.0	...	...	...	...	...	...	
Residual, including change in gross foreign assets (2-3) 3/	26.7	25.1	20.8	23.3	9.0	21.9	6.7	2.5	0.8	-1.0	2.1	
External debt-to-exports ratio (percent)	72.8	87.5	106.8	120.8	114.3	167.3	158.1	149.3	138.0	126.2	119.6	
Gross external financing need (billions of U.S. dollars) 4/	4.9	10.7	15.9	25.8	41.0	34.5	33.4	33.8	38.0	44.1	41.5	
Percent of GDP	7.5	12.4	14.7	18.0	22.9	29.7	27.7	25.7	25.9	27.2	23.3	
Scenario with key variables at their historical averages 5/						85.4	74.4	62.4	51.3	38.6	28.6	-7.3
Key macroeconomic assumptions underlying baseline												
Real GDP growth (percent)	12.1	2.6	7.3	7.9	2.1	-14.0	2.7	4.4	5.1	5.4	5.8	
GDP deflator in U.S. dollars (change in percent)	15.5	29.4	16.9	22.9	22.9	-24.8	1.2	4.1	6.4	4.7	3.8	
Nominal external interest rate (percent)	3.5	4.6	6.5	3.9	4.2	8.3	8.3	9.4	10.4	10.8	11.6	
Growth of exports (U.S. dollar terms, percent)	42.6	7.5	13.2	27.4	33.8	-30.8	9.8	8.8	9.8	7.3	7.5	
Growth of imports (U.S. dollar terms, percent)	31.3	20.4	22.0	35.4	38.8	-41.4	10.7	10.5	9.0	8.9	8.4	
Current account balance, excluding interest payments	11.9	4.6	0.8	-2.2	-5.4	7.6	6.9	5.7	5.7	4.6	3.7	
Net non-debt creating capital inflows	5.8	11.9	8.6	10.5	4.8	2.2	4.5	5.3	6.3	6.1	6.5	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in U.S. dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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.

Table 10. Ukraine: Indicators of Fund Credit, 2006–14

	2006	2007	2008	2009	2010	2011	2012	2013	2014
				Projection					
Existing and prospective Fund credit 1/ 2/									
Millions of SDRs	552	273	2,842	9,500	11,000	11,000	8,766	3,734	469
Percent of exports of goods and services	2	1	5	25	26	24	18	7	1
Percent of public sector external debt	6	3	22	52	52	51	43	23	3
Percent of gross reserves	3	1	14	50	55	54	41	18	2
Percent of quota	40	20	207	692	802	802	639	272	34
Existing Fund credit 1/ 2/									
Millions of SDRs	552	273	2,842	4,875	4,875	4,875	2,906	469	0
Percent of exports of goods and services	2	1	5	13	12	11	6	1	0
Percent of public sector external debt	6	3	22	26	23	22	14	3	0
Percent of gross reserves	3	1	14	25	25	24	13	2	0
Percent of quota	40	20	207	355	355	355	212	34	0
Prospective Fund credit 1/ 2/									
Millions of SDRs	0	0	0	4,625	6,125	6,125	5,860	3,265	469
Percent of exports of goods and services	0	0	0	12	15	14	12	6	1
Percent of public sector external debt	0	0	0	25	29	28	29	21	3
Percent of gross reserves	0	0	0	24	31	30	27	16	2
Percent of quota	0	0	0	337	446	446	427	238	34
Repurchases and charges due from existing and prospective drawings 2/ 3/									
Millions of SDRs	315	304	239	92	261	289	2,517	5,213	3,298
Percent of exports of goods and services	1	1	0	0	1	1	5	10	6
Percent of public sector external debt	18	19	17	3	16	15	127	73	73
Percent of gross reserves	2	1	1	0	1	1	12	25	16
Percent of quota	23	22	17	7	19	21	183	380	240
Repurchases and charges due from existing drawings 2/									
Millions of SDRs	315	304	224	45	67	67	2,028	2,466	472
Percent of exports of goods and services	1	1	0	0	0	0	4	5	1
Percent of public sector external debt	18	19	15	2	4	4	54	35	10
Percent of gross reserves	2	1	1	0	0	0	9	12	2
Percent of quota	23	22	16	3	5	5	148	180	34
Repurchases and charges due from prospective drawings 2/ 3/									
Millions of SDRs	0	0	16	47	194	222	489	2,747	2,827
Percent of exports of goods and services	0	0	0	0	0	0	1	5	5
Percent of public sector external debt	0	0	2	2	12	12	73	39	62
Percent of gross reserves	0	0	0	0	1	1	2	13	13
Percent of quota	0	0	1	3	14	16	36	200	206

Sources: Data provided by the Ukrainian authorities; and IMF staff estimates.

1/ End of period.
2/ Under the obligations schedule.
3/ Excluding commitment charges
4/ Public sector debt service including debt service from prospective drawings.

Table 11. Ukraine: Road Map for Structural Fiscal Reforms

Legislation	Status	Commitment
Fiscal reforms		
Revenue administration	FAD TA provided;	Cabinet to start implementing the national compliance improvement plan starting August 2009
Tax reform	FAD TA in August 2009 to identify measures	Identified measures to be included in the 2010 budget
Pension reform	High level committee to identify pension reforms measures, in consultation with WB and IMF	Identified measures to be included in the 2010 budget
Energy sector reform	Eliminate the gas subsidy by 2011; and improve transparency of Naftogaz	One-time gas price increase in 2009 and quarterly adjustments in 2010; Implementation of measure identified in the March Brussels declaration
New Initiatives		
Budget Code	Approved by Rada	Proper testing is needed; not to be used in the 2010 budget formulation
Euro 2012	Approved by Rada	Against NBU law and impinges on NBU independence; sources of funding other than advance NBU profits need to be identified
Minimum wage/pension bill	Passed first reading in Rada (to be voted for second reading in September)	Coalition members will not support it
Moratorium on tax audit	Approved by Rada	Government will not enforce it
Tax amnesty	Under consideration in Cabinet	The Cabinet will not submit it to Rada
Separation of Treasury from Ministry of Finance	Under consideration in Cabinet	The Cabinet will not approve it

APPENDIX I: UKRAINE: LETTER OF INTENT

Kyiv, July 23, 2009

Mr. Dominique Strauss-Kahn
Managing Director,
International Monetary Fund
Washington DC, 20431, U.S.A.

Dear Mr. Strauss-Kahn:

1. Like most European economies, the economy of Ukraine has been affected by the negative effects of the global financial and economic crisis. Weak external demand, the low level of international steel prices, the sharp increase of our energy import prices, and tight global financing conditions as well as a reduction of credit provided by the banking system have taken a severe toll on economic activity. However, in the last few months, financial strains in Ukraine have moderated significantly and there are some signs that the economy is stabilizing. Our efforts remain geared towards supporting macroeconomic stability and generating a rapid yet sustainable rebound of our economy.

2. Despite the difficult environment, policy implementation since the first review has been in line with our commitments. The end-May 2009 quantitative performance criteria on base money, net international reserves, and the cash deficit of the general government have been met. We have made progress with the resolution of the systemic problem banks and in preparing legislation to improve the bank resolution framework. We have also strengthened our efforts to raise financing for the budget from domestic sources, including by offering market rates in our treasury bills auctions.

3 In light of this performance and our continued commitment to the program, we request completion of the Second Review under the Stand By Arrangement. Given the sharp reduction in economic activity and its impact on public finances as well as the deterioration in the financial situation of Naftogaz, we request a broadening of the fiscal deficit target to include the deficit of Naftogaz and a modification of the performance criterion on the fiscal deficit. We have maintained import restrictions for two product groups, but these restrictions will expire on September 7, 2009. Finally, we would like to request that the full amount of the next tranche be disbursed directly to the budget to finance the fiscal deficit, including the repayment of the external obligations by the Government. We commit to full accountability and to provide information on a regular basis as to how the resources are being used.

4 We believe that the policies set forth in the letters of October 31 2008; April 30 2009; and this letter are adequate to achieve the objectives of our economic program, but we stand ready to take additional measures as appropriate. As is standard under all IMF arrangements, we will consult with the IMF before modifying measures contained in this letter or adopting

new measures that would deviate from the goals of the program, and provide the IMF with the necessary information for program monitoring.

Yours sincerely,

/s/ Yulia Tymoshenko Prime Minister of Ukraine	/s/ Victor Yushchenko President of Ukraine
/s/ Ihor Umanskiy Acting Minister of Finance	/s/ Volodymyr Stelmakh Governor of the National Bank of Ukraine

UKRAINE—MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

A. Macroeconomic framework

1. Due to the deepening of the global recession in the first quarter of 2009, weakening terms of trade, and the deterioration of financial conditions, the outflow of deposits and the contraction of credit to economy turned out worse than expected. As a result, the decline in real GDP in 2009 is expected to be more pronounced than the 8 percent that was projected at the time of the first program review, possibly reaching approximately -14 percent. However, going forward, we believe that the improvement of global economic conditions and the implementation of the policies of our economic program will facilitate the strengthening of our banking sector and general confidence, allowing for a resumption of the flow of credit to enterprises and households and a rebound of our export sector and economy. We expect our economy to grow by around 3 percent in 2010.

2. Developments in inflation and our balance of payments have been better than expected. Continued effective implementation of anti-inflation policies, the strengthening of our anti-crisis efforts, the coordination of monetary and exchange rate policies of the NBU with the fiscal policy of the Government, and the commitments under the joint economic program supported by the IMF have allowed us to bring inflation down. We now expect inflation at around 13 percent by the end of the year compared to 16 percent at the time of the first program review. Our balance of payment has adjusted significantly. During the first 5 months of 2009, merchandise imports and exports contracted by 52 percent and 44 percent, respectively, compared to the same period in 2008. Until May, rollover rates for private external debt held up relatively well. Our current account is expected to record a surplus of about 0.5 percent of GDP in 2009.

B. Fiscal Policy

3. At end-May, the cash deficit of the general government was 1.8 percent of GDP, below the program ceiling of 2.4 percent of GDP. However, the outlook for public finances has worsened significantly since the first program review and without offsetting measures, the general government deficit according to the projections may increase from 4 percent to 6.5 percent of GDP in 2009 (excluding bank recapitalization costs). We believe that it is appropriate to broaden the fiscal aggregates monitored under the program to explicitly cover the deficit of Naftogaz, estimated at 2.7 percent of GDP (Hrv 25 billion).

4. To keep our public finances in a structurally sound position, we have announced corrective measures amounting to 0.6 percent of GDP to contain the general government deficit to 6 percent of GDP in 2009, excluding banks' recapitalization costs and the Naftogaz deficit to 2.6 percent of GDP.

5. These measures, together with the structural measures and reforms we plan to implement in 2010, will help us contain the general government deficit in 2010, based on

realistic macroeconomic assumptions and revenue projections. This will start the process of fiscal consolidation and ensure medium term debt sustainability. We will not change the principles of state budget formulation policies for the next year. We have publicly committed to a 4 percent deficit target for 2010 and have taken the following measures:

- To improve the financial position of Naftogaz, we have capitalized Naftogaz by UAH 18.6 billion. We have also announced increases of gas tariffs paid by households (effective September 1, 2009) and utility companies (effective October 1, 2009) by 20 percent (prior action). This will bring these tariffs to the levels of 31 and 43 percent of import prices, respectively. We have also announced a schedule of 20 percent quarterly price increases for households and utility companies starting in January 2010 (prior action). We have formed a taskforce to enforce the existing social safety net to effectively protect poor households. Our objective is to achieve convergence of all tariffs with import prices, while maintaining effective safety nets to protect vulnerable groups.

- We have adjusted electricity tariffs (for consumption of electricity over 600 kw), taken measures to strengthen tax administration in line with IMF advice, and plan to reduce our expenditure by curtailing the expenditures for goods and services in non-priority areas. Social transfers will be better targeted as well.

- We have adopted and announced a time-bound road map describing the schedule and main steps in the design of pension and tax reform. We will issue, by end-September, a comprehensive analysis of the situation of the pension system and the tax system, on which basis we will recommend concrete policy actions by end-October 2009.

- We will contain local government expenditures, including payments to contractual workers, in line with the budgeted amounts and will not introduce any tax amnesty nor implement a moratorium on tax audits.

6. While we will continue to protect the most vulnerable groups of the population from the effects of the crisis, we are also aware that a quick adjustment of our economy to the large external shocks it is facing requires a temporary tightening of our incomes policies. Our strategy will thus be to continue to limit the increase in both minimum and average public wages and pensions, and other social transfers, in line with projected inflation in 2009 (average and end-period basis). We do not support the approval by the Parliament of the draft bills, which would envisage an increase in minimum wages and pensions to unsustainable levels for public finances, and any such bill will be vetoed.

7. We are fully committed to take structural measures to strengthen the financial situation, transparency, and governance of Naftogaz. By end-September, we will pass the legislative amendments in order to introduce the distribution accounts for the heating utilities and transfer the authority for setting the heating tariffs for communal utilities to the independent regulator (NERC), as well as eliminate the ban on penalties for households who

do not pay their gas and communal utility bills. We have adopted a revised 2009 financial plan and developed a 2010 projected financial plan (prior action) for the company which, in addition to the gas price increases mentioned above, envisages measures to increase payment discipline by households and utility companies, and a strengthened heating tariff setting mechanism. We have commissioned a special audit of Naftogaz by an international audit firm, to put in place a monitoring framework for the cash result of the company and to establish a regular (monthly) and timely public reporting of key financial data (prior action).

8. Efforts made in recent months to develop domestic financing sources for the government have started to bear fruit. We have been able to place increasing amounts of domestic debt in recent weeks as the bonds carried interest rates more closely aligned with market rates. We are continuing to actively work on procedures and instruments to develop a domestic debt market. In parallel, we are strengthening our efforts to secure additional funding from multilateral and bilateral creditors.

9. Within one year, the Government and the State Property Fund will privatize a number of substantial enterprises, in particular oblast energy distribution companies. In addition, the privatization of the "Odessa sea-port plant" will be completed in September on a competitive basis with a broadest possible involvement of international investors.

C. Monetary, Exchange Rate and Financial Sector Policies

10. We are making efforts to improve the functioning of the foreign exchange market. The official exchange rate is aligned with the average rate on the interbank market on the previous day with a deviation not exceeding 2 percent of the market rate. We have been able to seize on the recent positive developments in the foreign exchange market to buy a small amount of reserves. We have stepped up our efforts to lift administrative controls on the foreign exchange market, including by amending NBU regulation 108 to lift the ban on foreign exchange forward and spot transactions (prior action), and by bringing regulations 107 and 109 in line with international good practices.

11. While inflation continues to fall and pressures on the hryvnia have recently eased, which allowed us to reduce policy rates, we stand ready to tighten policies if pressures on the exchange rate or inflation were to reemerge. The outflow of deposits from the banking system has come to a halt, which has allowed us to revoke the requirement which limited the possibility of withdrawal of deposits prior to maturity. Going forward, we will closely monitor developments in monetary aggregates and bank liquidity and avoid a build up of a large monetary overhang.

12. We have tightened the criteria for access to central bank liquidity, both for the regular refinancing operations and for the liquidity support to problem banks. The agreed- upon-procedures arrangement by Ernst and Young on the provision of refinance credit and foreign currency to banks in the fourth quarter of 2008 was concluded. The preliminary results suggest that the NBU followed approved procedures and authorization policies in conducting

these operations. We have shared the results with the IMF, and will publish the main findings in accordance with the terms of reference for this arrangement that was agreed with the IMF.

13. With a view to strengthening the independence of the NBU we will, by end-September 2009, enact legislation to strengthen the overall governance structure of the NBU in line with our commitments under the program. We will also refrain from enacting legislation that impinges on NBU independence and will veto any initiatives to this effect.

14. To restore financial stability and the conditions for a resumption of bank lending, we intend to make rapid progress with our bank recapitalization and restructuring program. Shareholders of most systemic private banks have already brought in the capital and we will follow up closely with the shareholders of noncomplying banks to ensure that the remaining capital pledges materialize. To improve communications with the home supervisors of parent banks, we will aim to complete all pending MoUs by end-2009.

15. We will swiftly resolve the systemic problem banks. For the five systemic problem banks where shareholders are unable to bring in the necessary capital, we have finalized the resolution strategy and started implementation. Three of these banks have already been recapitalized and we expect to make a decision by end-July regarding the expediency of the state involvement in replenishing the capital of the other two banks. (prior action). This strategy includes identifying a fair value of shares, recapitalization by the government and appointment of a professional management. The banks will undergo a thorough due diligence that includes an assessment of restructuring options post-recapitalization. To ensure rapid progress, we have completed the setup and staffing of the relevant units at the MoF and in the NBU. In the implementation of the recapitalization program, we will avoid undue monetary expansion and safeguard the financial position of the NBU.

16. We have recapitalized the two state banks in line with the diagnostic results. By September 2009, we will develop a set of measures to strengthen their financial sustainability.

17. Preparations for the workouts of the non-systemic insolvent banks have been progressing apace. The diagnostic studies for the Group 3 and 4 banks have been completed, and banks have been informed about the needed capital increase by end-2009.

18. Legal amendments to identify ultimate controllers of banks and to strengthen the bank resolution process, which will form the basis for the workouts of the non-systemic insolvent banks, have been adopted (prior action). For these banks we will finalize the resolution strategy and start its implementation by end-September, 2009.

19. More broadly, to strengthen our supervision framework, we are preparing amendments to legislation with a view to implementing consolidated supervision and provide for supplementary supervision of financial conglomerates. We plan to have these amendments enacted by May 2010. Since April 2009, we have also required banks to disclose detailed financial information.

Appendix I. Table 1. Ukraine: Access and Phasing Under a Proposed Stand-By Arrangement 1/

Date Available	Millions of SDRs	Percent of Quota	Conditions Include
November 2008	3,000	218.7	Board approval of arrangement
1 May 2009	1,875	136.7	Observance of end-March 2009 performance criteria, prior actions and completion of the first review
15 June 2009	2,125	154.9	Observance of end-May 2009 performance criteria, prior actions and completion of the second review
15 November 2009	2,500	182.3	Observance of end-September 2009 performance criteria and completion of the third review
15 February 2010	375	27.3	Observance of end-December 2009 performance criteria and completion of the fourth review
Quantitative and structural performance criteria for remaining scheduled purchases in 2010 are expected to be established at the time of the third review.			
15 May 2010	375	27.3	Observance of end-March 2010 performance criteria and completion of the fifth review
15 August 2010	375	27.3	Observance of end-June 2010 performance criteria and completion of the sixth review
15 October 2010	375	27.3	Observance of end-September 2010 performance criteria and completion of the seventh review
Total	11,000	802	

Source: IMF staff estimates.

1/ Reflects the rephasing of the second and third purchases requested in the LOI.

Appendix I. Table 2. Ukraine: Quantitative and Continuous Performance Criteria 1/

(End of period; millions of hryvnia, unless otherwise indicated)

		2009			
	Dec. 2008	Mar.	May.	Sep.	Dec.
	Stock (actual)			Prog.	Prog.
I. Performance criteria					
Ceiling on the cash deficit of the general government (- implies a surplus) 2/ 3/ 4/ 5/ 6/	30,026	11,040	22,500	40,000	55,000
Ceiling on the cash deficit of the general government including Naftogaz (- implies a surplus) 2/ 3/ 4/ 5/	30,026	10,097	21,847	58,600	79,100
Floor on net international reserves of the NBU (in millions of U.S. dollars)	27,811	22,238	20,799	16,600	14,900
Ceiling on base money	186,671	174,764	181,681	210,000	211,000
II. Continuous performance criteria					
Prohibition on the imposition or intensification of restrictions on the making of payments and transfers for current international transactions					
Prohibition on the introduction or modification of multiple currency practices					
Prohibition on the conclusion of bilateral payments agreements that are inconsistent with Article VIII					
Prohibition on the imposition or intensification of import restrictions for balance of payments reasons					
III. Adjusters					
Project financing 2/	799	324	1,050	1,568	2,091
Cost of bank recapitalization 3/	0	0	0	0	0
Stock of budgetary arrears on social payments 4/	76	...	100	100	100

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

1/ Definitions are specified in the Technical Memorandum of Understanding (TMU). Targets for 2010 will be set at the time of the third review.

2/ The quarterly ceilings are set taking into account the seasonality of the deficit. The ceiling on the cash deficit of the general government will be adjusted downward by the amount that project financing falls short of the projections shown in Section III above.

3/ The ceiling on the cash deficit of the general government will be adjusted upward by 100 percent of the fiscal cost of banks recapitalization. This cost includes both the upfront cost for the budget as well as associated subsequent interest payments.

4/ The ceiling on the cash deficit of the general government will be adjusted downward by the amount that budgetary arrears on social payments exceed the projections shown in Section III above; respect of the ceiling will be monitored on a quarterly basis.

5/ Data are cumulative flows from January 1 of the corresponding year.

6/ Excluding any bonds issued for capitalization of Naftogaz.

Appendix I. Table 3. Ukraine: Prior Actions for the Completion of the Second Review and Structural benchmarks

Prior Actions for the Second Review

A1. Amend legislation to enable effective bank resolution. The amendments should include revaluation of shareholder capital, transfer of assets and liabilities without prior approval of creditors, simplifying and accelerating the process for bank mergers and acquisitions, enabling the government to provide funds for banks under resolution by the NBU, and definition and disclosure of ultimate controllers of banks.

A2. Finalize the resolution strategy for each of the systemic problem banks and start implementation. In particular, implement the recapitalization for the three banks for which the decision thereto has already been taken, and decide on the expediency of the state involvement in replenishing the capital of the other two banks.

A3. Announce an increase in the price of natural gas paid by households (effective September 1) and utility companies (effective October 1) by 20 percent to bring these tariffs at 31 and 43 percent of import prices, respectively, and announce a schedule of 20 percent quarterly price increases for households and utility companies starting in January 2010. Introduce mechanisms to enforce payment discipline of utility companies and households.

A4. To improve transparency of Naftogaz: approve a revised 2009 financial plan and develop a 2010 projected financial plan for Naftogaz, based on credible financing assumptions, and commission an independent review, by an international audit firm, to put in place a monitoring framework for the cash result of the company and to establish regular (monthly) and timely public reporting of key financial data.

A5. Improve the functioning of the foreign exchange market, including by amending NBU regulation 108 to lift the ban on foreign exchange forward and spot transactions.

Structural Benchmarks	***Date***
B1. Enact legislation to strengthen the overall governance structure of the NBU; in particular, reform the NBU council, transforming it into a narrower technical body and revise the NBU Law as needed to address all safeguards-related weaknesses, as noted by the recent safeguards assessment.	End-Sept 2009
B2. Amend the Law of Ukraine "On restoring solvency of a debtor or announcing him/her a bankrupt" and related laws to facilitate voluntary out-of-court rehabilitation and by reducing the scope for excessive appeals.	End-Sept 2009
B3. Publish detailed information on banks, in particular detailed balance sheets and income statements, information on bank capitalization, ownership and asset quality, with separate information for domestic and foreign currency assets and liabilities.	End-Sept 2009
B4. Finalize the resolution strategy for each of the non-systemic problem banks and start implementation.	End-Sept 2009
B5. Initiate the implementation of the reform and restructuring strategy for Naftogaz, including a mechanism for transparent financing of gas transit modernization needs, in accordance with the principles of the Brussels declaration.	End-Sept 2009
B6. Develop a set of measures to strengthen the financial sustainability of State banks.	End-Sept 2009
B7. Eliminate the foreign exchange transaction tax.	End-Sept 2009
B8. Enact necessary amendments to legislation to implement consolidated supervision and provide for supplementary supervision of financial conglomerates.	End-May 2010

UKRAINE—TECHNICAL MEMORANDUM OF UNDERSTANDING

July 23, 2009

1. This memorandum sets out the understandings between the Ukrainian authorities and IMF staff regarding reporting requirements and definitions of quantitative targets and structural measures for the economic program supported under the Stand-By Arrangement, as described in the authorities' Letter of Intent dated April 15, 2009 and the attached Memorandum of Economic and Financial Policies (MEFP).

2. 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. Prior actions, structural benchmarks are listed in Table 3 of the MEFP, with corresponding definitions in Section II below. Reporting requirements are specified in Section III.

I. QUANTITATIVE TARGETS

A. Floor on Net International Reserves of Ukraine

3. Net international reserves (NIR) of Ukraine are defined as the difference between usable gross international reserve assets and reserve-related liabilities to nonresidents, evaluated at program exchange rates (see below). Usable gross international reserve assets comprise all reserve assets (Table A, item 1), to the extent that they are readily available for intervention in the foreign exchange market and held in first-rank international banks or as securities issued by G-7 countries. 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). Excluded are, *inter alia*, 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, 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 of lack of quality or lack of liquidity that limits marketability at the book price.

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

- all short-term liabilities of the NBU vis-à-vis nonresidents with an original maturity of one year or less;
- the stock of IMF credit outstanding; and
- the nominal value of all derivative positions[2] of the NBU and government, implying the sale of foreign currency or other reserve assets against domestic currency.

Components of Net International Reserves

Type of Foreign Reserve Asset or Liability[3]		NBU Balance Sheet and memorandum Accounts
1.	**Gross foreign reserves** *(in convertible currencies)*	
	Monetary gold in vault	1100, 1107
	Foreign exchange in cash, including Russian rubles	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[4]
	Securities issued by nonresidents	1302, 1305, 1307, 1308, minus 1306
2.	**Short-term liabilities to nonresidents** *(in convertible currencies)*	
	Correspondent accounts of nonresident banks	3201
	Short-term deposits of nonresident banks	3206, 3207, 3211
	Operations with nonresident customers	3230, 3232, 3233, 3234
	Use of IMF credit	IMF, Finance Department

5. For program purposes, the exchange rates used to evaluate reserve levels are the official exchange rates determined by the NBU as of September 30, 2008. In particular, the Swiss Franc is valued at 0.9056 dollar, the Euro is valued at 1.4349 dollars, Pound Sterling is valued at 1.8029 dollars, the Japanese yen at 106.1346 per dollar. The accounting exchange rate for the SDR will be 1.56407 per dollar. Official gold holdings were valued at 833.95 dollars per troy ounce. These program exchange rates are kept fixed over the program period. Therefore, the program exchange rate differs from the actual exchange rate set in the

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

[3] 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 September 30, 2008. 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.

[4] 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.

foreign exchange market. 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.

B. Ceiling on Monetary Base of the NBU (Base Money)

6. The NBU's monetary base comprises domestic currency outside banks and banks' reserves, including cash in vault of commercial banks,[5] and funds of customers at the NBU. 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, 3204, and 3206) plus funds of customers at the NBU in hryvnia (NBU liabilities accounts 3230, 3232, 3233, 3234, 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 (NBU liability account 3238).

C. Ceiling on Cash Deficit of the General Government

Definition

7. The general government comprises the central government, all local governments, and all extrabudgetary funds, including the Pension, Employment, Social Insurance for Temporary Disability, State Material Reserve, Leasing, Occupational Accident and Sickness Insurance, and State Property funds. The consolidated 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 extrabudgetary funds listed above, as well as any other extrabudgetary funds included in the monetary statistics compiled by the NBU. The cash deficit of the general government is measured from below the line as:

- total net treasury bill sales 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 less the cumulative total redemption of principal on treasury bills); plus

- other net domestic banking system credit to government as measured by the monetary statistics provided by the NBU (this consists of all non-treasury-bill financing in

[5] 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.

either domestic or foreign currency extended to the government by banks less the change in all government deposits in the banking system); plus

- total receipts from privatization received by the SPF and local governments; plus
- the difference between disbursements and amortization on any bond issued by the government or the NBU to nonresidents for purposes of financing the deficit of the general government; plus
- the difference between disbursements of official foreign credits to the general government (including project loans on-lent to public enterprises) and the amortization of official foreign credits by the general government (including of on-lent project loans, and excluding offset-based amortization with Russia); plus
- the net change in 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.

8. For the purposes of measuring the deficit of the general government, all flows to/from the budget in foreign currency will be converted into hryvnia at the official exchange rate prevailing at close of business on the date of the transaction.

Adjustment mechanism

9. The ceiling on the cash deficit of the general government is subject to an automatic adjuster based on deviations of external project financing (defined as disbursements from bilateral and multilateral creditors to the state budget for specific project expenditure) from program projections (shown in Table 2 of the MEFP). 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.

10. The ceiling on the cash deficit of the general government is subject to an automatic adjuster corresponding to the budgetary costs associated with the recapitalization of banks. These costs affect the cash deficit of the general government as defined above in two ways:

first, through the upfront cost for the budget of the recapitalization; second, via the associated subsequent interest payments. These costs are excluded from the calculation of the fiscal targets defined in the program. Specifically, the ceiling on the consolidated general government deficit will be adjusted upward by 100 percent of this cost.

11. The ceiling on the cash deficit of the general government is subject to an automatic adjuster on the stock of budgetary arrears on social payments. Budgetary arrears on social payments comprise all arrears of the consolidated budget on wages, pensions (including on Chernobyl pensions), and social benefits owed by the Pension Fund, the central, or local governments (including Chernobyl benefits). 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, including, but not limited to, payments in cash and in-kind for standard and overtime work. Pension obligations of the Pension Fund comprise all pension benefits and other obligations of the Pension Fund.

D. Ceiling on Cash Deficit of the General Government including Naftogaz

Definition

12. The cash deficit of the General Government including Naftogaz is the cash deficit of the General Government as defined above plus the cash deficit of Naftogaz.

13. Naftogaz comprises the national joint stock company "Naftogaz of Ukraine" and its nine subsidiaries (Ukrgasproduction, Chomomornaftogaz, Ukrtransgas, Ukratransnafta, Gas of Ukraine, Dnipropetrovskgas, Luganskgas, Zaporizhgas, and Mykolayivgas), as audited by an international auditor. The cash deficit of the 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 from Gazprom to import gas; plus
- the difference between disbursements and amortization on any bonds issued by the company; plus

- the difference between disbursements of loans from the Single Treasury Account and the amortization of loans from the Single Treasury Account; plus
- the net change in deposits of the company in nonresident banks, or other nonresident institutions; plus
- net proceeds from any promissory note or other financial instruments issued by the company; plus
- total receipts from sale of assets received by the company; plus
- any other forms of financing of the company not identified above.

14. For the purposes of measuring the deficit of Naftogaz, all flows in foreign currency will be converted into hryvnia at the official exchange rate prevailing at close of business on the date of the transaction.

II. OFFICIAL EXCHANGE RATE

Determination of the official exchange rate

15. The NBU will, on a daily basis, set the official rate at the average transaction-weighted rate of the preceding day (with intraday adjustments if necessary to keep it within 2 percent of the market rate).

III. REPORTING REQUIREMENTS

A. National Bank of Ukraine

16. The NBU will continue to provide to the IMF on a monthly basis, no later than the 25th day of the following month, an aggregate balance sheet for the NBU and a consolidated balance sheet for the deposit money banks.

17. The NBU will provide to the IMF on a weekly and monthly basis, no later than the 25th of the following month, the full breakdown of NBU accounts included in net international reserves (defined in Table A above), at both actual and program exchange rates.

18. The NBU will continue to provide on its web site the weekly report on the primary treasury bill market, reports on each treasury bill auction, and provide to the IMF the monthly report on treasury bills.

19. The NBU will provide the IMF, no later than the 25th of each month, with data on the total financing (including refinancing) issued by the NBU to commercial banks, broken down by original maturity of the financing.

20. Every 10 days, the NBU will continue to provide the IMF with the operational monetary survey of the NBU, including any additional information that is needed for the IMF staff to monitor monetary policy and developments in the banking sector.

21. The NBU will continue to provide to the IMF the daily operational balance sheets of the NBU and commercial banks on a daily basis according to standard reporting forms, including detailed information on loans of the banking sector provided to the general government, with weekly detailed breakdown of this information by indebtedness of the central government and local budgets, including in national and foreign currency, by loan and by security.

22. The NBU will provide to the IMF, on a monthly basis, a projection for external payments falling due in the next twelve months.

23. The NBU will provide to the IMF, on a quarterly basis, the stock of external debt for both public and private sector.

24. The NBU will provide to the IMF on a daily basis the standard daily data sheet on government foreign receipts and payments, breakdown of interbank market operations by currencies, explanations for main currency flows. The NBU will continue to provide daily information on exchange market transactions, including exchange rates.

25. The NBU will provide to the IMF reports N 381.25; 381.26 with information on reserve requirements and reports on CD operations when performed.

26. The NBU will continue to provide on a monthly basis, no later than 25 days after the end of the month, banking system monitoring indicators in an agreed format.

27. The NBU will provide to the IMF consolidated banking sector data and aggregated data (without specifying the names of the banks) for the largest banks (accounting for at least 80 percent of the total banking system assets) on a quarterly basis, no later than 30 days after the end of the quarter: (i) balance sheet; (ii) loan classification (standard, watch, substandard, doubtful, loss); (iii) provisions for all assets (required and actual) (iv) foreign currency denominated lending and deposits; (v) capital adequacy ratios for normative and regulatory capital (Tier II and I), normatives H2 and H3; weighted averages based on banks' total assets; and (vi) liquidity normatives H5 and H6; weighted averages based on banks' total assets.

28. The NBU will continue to provide quarterly balance of payments data in electronic format.

29. The NBU will provide data on credit to nongovernment units that is guaranteed by the NBU on a monthly basis no later than 25 days after the end of the month.

30. The NBU will inform IMF staff if the Treasury does not pay interest or principal on treasury bills 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.

31. The NBU will inform IMF staff of any changes to reserve requirements for deposit money banks.

32. The NBU will communicate in writing to the IMF staff any changes in accounting conventions and valuation principles incorporated into the balance sheet data and will notify the staff before introducing any change to the Charts of Accounts of the NBU and the Commercial Banks, as well as changes in the reporting forms.

33. 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.

34. 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.

B. Ministry of Finance

35. The Treasury will continue to provide to the IMF its report on daily operational budget execution indicators, on a 10-day basis data on revenue of the state, local government, and consolidated budget revenues.

36. The Treasury will continue to provide to the IMF in electronic form monthly treasury reports, including revenue and expenditure figures of the consolidated, state and local government, no later than 25 days after the end of the month. These reports will provide expenditure data by programs and key spending units, as well as based on standard functional and economic classifications.

37. The Ministry of Finance 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.

38. The Ministry of Finance will continue to report the final fiscal accounts at the end of each fiscal year, no later than March of the following year. These reports will provide expenditure data by programs and key spending units, as well as based on standard functional and economic classifications.

39. The Ministry of Finance will report any revisions to monthly and annual fiscal reports as well as any amendments to the state budget and local government budgets within a week after their approval.

40. 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.

41. The Ministry of Finance will also provide, on a monthly basis, information on the borrowing (disbursements, interests and amortization) for the following state-owned companies: Naftogaz, UrkAvtoDor, UkrZaliznytsya, Ukrtelecom and Energoatom.

42. The Ministry of Finance will provide data on the stock of all budgetary arrears on a monthly basis, no more than 25 days after the end of the 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 and functional classification).

43. 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 general government.

44. 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.

45. The Ministry of Finance and the NBU will provide data on external and domestic credit to nongovernment units that is guaranteed by the government or the NBU on a monthly basis no later than 25 days after the end of the month.

46. 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), Social Insurance Fund, Employment Fund (detailed data on the breakdown of revenues and expenditure by main

categories are expected for this Fund), Occupational Accident and Sickness Insurance Fund, and any other extrabudgetary funds managed at the state level no later than 25 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 years, no later than April of the following year.

47. The Ministry of Finance will report semi-annual data on the number of employees of budgetary institutions financed from the central and local budgets, starting from January 2008. After any public sector wage increase, the Ministry of Finance will provide an estimate of its costs for the current and subsequent fiscal years, for the state and local government budgets.

48. 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. This cost includes the upfront impact on the cash deficit of the general government of the recapitalization of banks as well as the costs associated with the payment of interests.

49. The Ministry of Finance will provide quarterly data on the revenues, expenditures and net lending of the Agrarian Fund.

50. The Ministry of Finance will provide weekly data on the outstanding balance of the single Treasury account compartmentalized into funds ascribed to (a) general fund of the state budget; (b) special fund of the state budget with a subcategory for own receipts of budgetary institutions; (c) local budgets; and (d) other funds as well as data on net outstanding temporary loans to Pension Fund and local budgets.

C. State Tax Administration

51. The State Tax Administration (STA) 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										

52. The STA will provide monthly data, no later than 25 days after the end of the month, on the stock and flow of tax arrears in the energy industry, in total and separately for the

electricity, gas and coal sectors; the list (identifying taxpayers) of the 10 largest accumulated stocks of tax liabilities at the end of the month, and the list (identifying taxpayers) of the 10 largest additions to the stock of arrears during that month (flow). These lists should be prepared separately for the electricity, gas and coal sectors.

53. The STA will provide on a quarterly basis, no later than 25 days after the end of the quarter, aggregate data on tax arrears in the above format for the 50 largest tax debtor enterprises, and their cumulative monthly tax payments since the beginning of the year.

54. The STA will continue to provide on a quarterly basis, no later than 2 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.

55. The STA 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) netted out against obligations of the taxpayer; (iv) netted out in line with Cabinet of Ministers' resolutions #85 of February 4, 2009, and #312 of April 2, 2009; (v) denied requests; (vi) new refund requests; (vii) end-of-period stock; and (viii) stock of end-of-period requests that are overdue in accordance with the VAT law (currently, refunds are overdue after 1 month for exporters and 3 months for other VAT taxpayers). It is understood that while monthly data could be operational, quarterly figures will be subject to verification and will be final.

D. Ministry of Economy and Ministry of Fuel and Energy

56. 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). In addition, the Ministry of Economy, the Ministry of Housing and Municipal Economy of Ukraine, and the National Energy Regulatory Commission will provide the methodology underlying the tariff calculations for full cost recovery, including electricity and gas.

57. For each month, no later than the 25th of the following month, the government (based on information by the Ministry of Fuel and Energy, the Ministry of Economy, STA, MoF, NERC, and *Naftogaz*) will provide IMF staff with information in electronic form (in an agreed format) on financial indicators in the gas, electricity and coal sectors, including sales, tariffs, arrears, payments to the budget, subsidies, and debt.

58. For each month, no later than the 25th of the following month, the government (based on information by Naftogaz) will provide IMF staff with information in electronic form (in an agreed format) on the cash deficit of the company, as defined above.

E. State Statistics Committee

59. The state Statistics Committee and *Naftogaz* will provide to the IMF, on a monthly basis, no later than 45 days after the end of the month, data on prices, volumes, and payments for imported and exported oil and natural gas by country of origin and destination.

INTERNATIONAL MONETARY FUND

UKRAINE

Second Review Under the Stand-By Arrangement and Request for Modification of Performance Criteria—Informational Annex

Prepared by the European Department in Consultation with Other Departments

Approved by Poul M. Thomsen and Lorenzo Giorgianni

July 23, 2009

Contents Page

APPENDIX I: UKRAINE—FUND RELATIONS

(As of June 30, 2009)

I. Membership Status: Joined 09/03/1992; Article VIII

II. General Resources Account:	**SDR Million**	**Quota**
Quota	1,372.00	100.00
Fund holdings of currency	6265.40	456.66
Reserve position in Fund	0.02	0.00

III. SDR Department:	**SDR Million**	**%Allocation**
Holdings	3.13	N/A

IV. Outstanding Purchases and Loans:	**SDR Million**	**%Quota**
Stand-By Arrangements	4,875.00	355.32
Extended arrangements	18.40	1.34

V. Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR Million)
Stand-By	11/05/08	11/04/10	11,000.00	4875.00
Stand-By	03/29/04	03/28/05	411.60	0.00
EFF	09/04/98	09/03/02	1,919.95	1,193.00

VI. Projected Payments to Fund (Expectations Basis)[1]

(SDR million; based on existing use of resources and present holdings of SDRs):

	2009	2010	2011	2012	2013
Principal	18.40			1968.75	2437.50
Charges/Interest	47.48	96.18	96.18	77.39	28.72
Total	65.88	96.18	96.18	2046.14	2466.22

[1] This schedule presents all currently scheduled payments to the IMF, including repayment expectations and repayment obligations. The IMF Executive Board can extend repayment expectations (within predetermined limits) upon request by the debtor country if its external payments position is not strong enough to meet the expectations without undue hardship or risk.

VII. Exchange Arrangements:

In September 1996, the authorities introduced the hryvnia (Hrv) at a conversion rate of karbovanets (Krb) 100,000 to HRV 1. The rate was initially informally pegged to the dollar. In September 1997, the peg was replaced by a formal band of Hrv 1.7–Hrv 1.9 per U.S. dollar. The limits of the band were moved on several occasions. Since March 19, 1999, the exchange rate for the hryvnia has been determined by the interbank market for foreign exchange. On February 22, 2000, the NBU officially confirmed its intention to allow the free float of the hryvnia, but intervened regularly to limit fluctuations to a small band, first around Hrv 5.33 per U.S. dollar, and from March 2005, around Hrv 5.05 per U.S. dollar. It was classified as a de facto peg. From April 2008, the exchange rate arrangement has been reclassified as a managed float.

On September 24, 1996, Ukraine accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement, and two remaining restrictions were eliminated in May 1997. A number of new restrictions on current international transactions were introduced in September 1998, and were removed in March 1999.

VIII. Article IV Consultation:

The discussions for the 2008 Article IV Consultation took place in Kyiv between March 20 and April 1, 2008. The concluding statement of the mission was posted at www.imf.org on April 16, 2008.

The IMF team comprised Messrs. Ford (Head), Flanagan, Moulin (all EUR), Mr. Driessen (MCM), Ms. Zakharova (FAD), Mr. Hofman (PDR), and Mr. Horvath, Resident Representative.

The mission met with NBU Governor Stelmakh, Finance Minister Pynzenyk, Economy Minister Danylyshyn, First Deputy Chief of Staff to the President Shlapak, other senior officials, representatives of parliament, the diplomatic community, financial sector, and think tanks. Mr. Yakusha (OED) attended the discussions.

A separately published *Selected Issues* Paper provides background on two topics: (1) Two Aspects of the Ukrainian's Business Cycle; (2) Strengthening Ukraine's Fiscal Framework. A *Working Paper* provides background on Resolving Large Contingent Fiscal Liabilities.

IX. FSAP Participation

A joint World Bank–International Monetary Fund mission conducted an assessment of Ukraine financial sector as part of the Financial Sector Assessment Program (FSAP) between May 10–24, 2002. An update mission visited Ukraine between February 18–21, 2003, and the Financial Sector Stability Assessment (FSSA) report (IMF Country Report No. 03/340) was considered by the Executive Board on May 14, 2003. The observance of the following standards and codes was assessed: Basel Core Principles for Effective Banking Supervision; Code of Good Practices on Transparency in Monetary and Financial Policies; CPSS Core Principles for Systemically Important Payment Systems; OECD Principles for Corporate Governance; Accounting and Auditing Practices; World Bank's Principles and Guidelines for Effective Insolvency and Creditor Rights System; and AML/CFT Methodology.

A further update mission visited Ukraine between June 11–22, 2007 and July 9–20, 2007. The observance of the following standards and codes was assessed: Basel Core Principles for Effective Banking Supervision; and IOSCO Core Principles of Securities Regulation. An updated Financial Sector Stability Assessment (FSSA) was considered by the Executive Board as part of the 2008 Article IV consultation.

X. ROSCS

A Data ROSC Module was conducted in April 3–17, 2002, and was considered by the Executive Board on August 5, 2003 (IMF Country Report No. 03/256). A Fiscal Transparency Module (experimental) was issued in September 1999, and an update in April 2004 (IMF Country Report No. 04/98).

XI. SAFEGUARD ASSESSMENT

An update safeguards assessment of the NBU was completed on April 16, 2009 in connection with the Stand-By Arrangement that was approved on November 5, 2008. The assessment concluded that the NBU continues to publish externally audited financial statements and has strengthened aspects of its safeguards framework since the 2004 assessment, in particular the internal audit function. However, the ongoing economic crisis has significantly increased the NBU's financial and operational risks and independence has been impaired in the past by ad hoc legislation. A weak governance structure, lack of independent audit oversight, and non-transparent decision-making add further safeguards risks. To address the reputational concerns caused by the non-transparent decision-making, an external review of the NBU's liquidity support and foreign exchange operations during the fourth quarter of 2008 was recommended and subsequently conducted by Ernst & Young Kiev. Enactment of legal revisions were proposed to strengthen independence and the governance structure, provide for independent audit oversight, and ensure consistency in the financial reporting. To safeguard data integrity and compliance with program definitions during the arrangement, the NBU Internal Audit Department agreed to review the monetary data at program test dates and formally report its findings to the Fund.

Press Release No. 09/271
FOR IMMEDIATE RELEASE
July 28, 2009

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Second Review Under Stand-By Arrangement with Ukraine and Approves US$3.3 Billion Disbursement

The Executive Board of the International Monetary Fund (IMF) completed today the second review of Ukraine's economic performance under the two-year Stand-By Arrangement (SBA), and approved the immediate release of the third tranche under the arrangement equivalent to SDR 2.12 billion (about US$3.3 billion). This will bring total disbursements under the SBA to SDR 7 billion (about US$10.9 billion).

With the completion of this review, the Executive Board also approved the modification of a performance criterion on the fiscal deficit in response to a broadening of the fiscal deficit target to include the deficit of Naftogaz.

The SBA with Ukraine was approved on November 5, 2008 in an amount equivalent to SDR 11 billion (about US$16.4 billion; see Press Release No. 08/271).

Following the Executive Board discussion, Mr. John Lipsky, First Deputy Managing Director and Acting Chair, said:

"Financial stress has eased in recent months and Ukraine's current account is adjusting rapidly. At the same time, the fall in output is more pronounced than expected, which has necessitated further significant policy adjustments. The revised economic program continues to seek to mitigate the effects of the global crisis, restore confidence in the banking system, and preserve fiscal sustainability, while protecting the most vulnerable segments of the population.

"To cushion the impact of the sharper economic contraction and to reflect the imbalances of the state gas company Naftogaz, the revised economic program targets a broadened fiscal deficit. Corrective fiscal measures and structural reforms are a priority to ensure fiscal sustainability and to avoid crowding out of private sector borrowing. The authorities have reduced nonpriority expenditures as well as taken a number of steps to restore viability in the natural gas sector. A key step is a schedule of natural gas price increases to bring domestic prices in line with international prices. Vulnerable households will be protected by a better targeting of the social safety net programs. The authorities are also moving ahead with a strategy to strengthen the financial situation and transparency of Naftogaz. Plans for pension and tax reforms in the context of the 2010 budget will also help entrench fiscal sustainability and reduce fiscal financing needs.

“The monetary policy stance is adequate. The National Bank of Ukraine (NBU) will closely monitor developments in monetary aggregates and stands ready to tighten its policies if inflation or exchange rate pressures were to reemerge. The NBU has also taken measures to increase currency flexibility in both directions, including by amending regulation to allow foreign exchange forward transactions. Further progress in this area will help Ukraine to adjust better to external shocks, discourage dollarization and excessive risk taking by unhedged borrowers, and allow monetary policy to focus on inflation objectives.

“Restoring confidence in the banking system, which is essential to facilitate the economic recovery, remains a key priority. Recent important steps include the recapitalization of the systemic banks, the decisions taken with regard to two other banks, and the adoption of legal amendments to enable the resolution of nonsystemic banks.

“The authorities plan to phase out remaining import restrictions in line with their commitments under the program.

“Going forward, close adherence to the program will be key to create the conditions that facilitate an expeditious economic recovery,” Mr. Lipsky stated.