Contents Page

Boxes

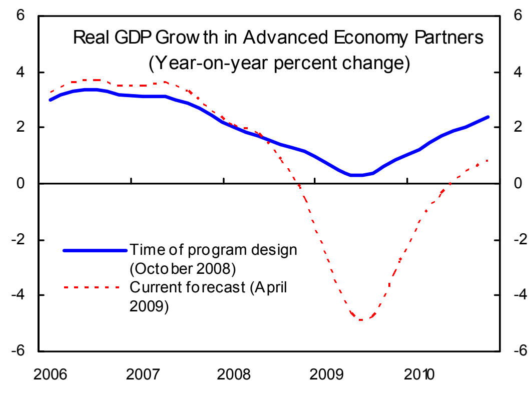
Figures

Tables

Appendix

I. Introduction and Summary

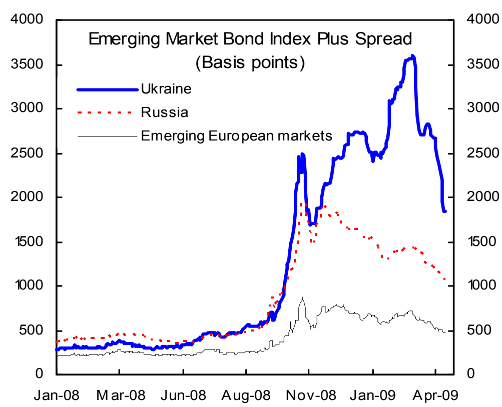
1. **The global economic and financial crisis has taken a severe toll on Ukraine and policy implementation has been uneven.** Economic growth in partner countries and global financial market conditions have turned out worse than anticipated at the time the program was approved. As a result, economic activity has contracted sharply, resulting in budgetary strains. Confidence in the banking system has waned, causing a continuous drain of deposits. At the same time, political tensions and concerns about private sector defaults have kept CDS and bond spreads at distressed levels. The gas dispute between Gazprom and Naftogaz in January intensified tensions between the political leaders in Ukraine, and disagreements on policy adjustments led to delays in the completion of the review.



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

2. **The policy settings under the program have been revised in light of the deterioration in the macroeconomic outlook:**

- The fiscal target for 2009 has been revised from balance in the original program to a 4 percent of GDP deficit. Given better-than-expected developments in the balance of payments—with sharp current adjustment more than offsetting the deterioration of the financial account—the higher fiscal deficit can be financed without increasing the external financing need, in part by redirecting Fund support to the budget. Nevertheless, to ensure adequate cushion, staff also supports the authorities' efforts to mobilize additional financing from the donor community. The adequacy of external financing will be reconsidered in the context of the next program review.



Source: Bloomberg.

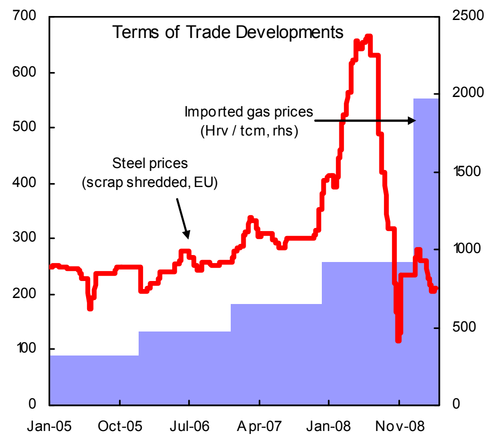
- A flexible exchange rate policy, supported by base money targets and a transparent intervention strategy remains a key component of the program. Given balance sheet effects associated with unhedged foreign currency borrowing, the central bank stands ready to take action to avoid excessive exchange rate depreciation, including by further tightening of monetary policy.

- Measures are urgently needed to restore confidence in the banking system. Insolvent banks should be resolved, and the next steps of the bank recapitalization program should be implemented without delay, based on transparent technical criteria. Legal amendments supporting these policies should be rapidly implemented.

3. **The authorities are committed to implement their revised program, but implementation risks remain**. The authorities have publicly announced the program details, and the Ministry of Finance and the National Bank of Ukraine are coordinating effectively to resolve problem banks and to restore financial stability. Going forward the most significant risk is further political tensions that may disrupt the implementation of the program—on April 1, the Parliament adopted a resolution to advance presidential elections from January 2010 to October 2009. The political situation in Ukraine remains fragile, with the ruling coalition short of a stable majority in parliament. Other key risks include a further deterioration in the outlook for trading partners, a further delay in the expected improvement in global financial conditions and implications for the commitment of parent banks, and a sharper-than-projected contraction in domestic demand.

II. Recent Developments and Outlook

4. **The economic downturn has been sharper than originally envisaged, mostly reflecting the deterioration of the external environment** (Table 1, Figure 1). As a major steel exporter and borrower in international markets, Ukraine's private sector has been hit hard by the deeper and more protracted slowdown of the world economy, the associated decline in demand for steel products and the sharply reduced access to capital markets. The economic impact of the external shocks was exacerbated by the pre-existing economic and financial vulnerabilities (Table 2)—in particular, widespread dollarization of private sector liabilities, balance sheet mismatches, concentration of exports in a limited number of commodities, and high inflation. Real GDP contracted by some 8 percent in the last quarter of 2008, reducing annual growth for 2008 to 2.1 percent, and there is strong evidence of a further weakening in the first quarter of 2009, as suggested by the decline in industrial production.

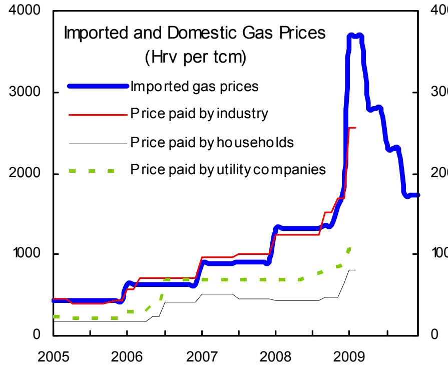


Sources: National bank of Ukraine; and IMF staff estimates.

5. **The economic contraction has led to fiscal underperformance relative to program targets, despite good expenditure control** (Table 3, Figure 2). The general government recorded a 3.2 percent of GDP deficit in 2008, compared to a 1 percent of GDP ceiling under the program. The higher deficit was due to a significant shortfall in revenues, deterioration of tax compliance, and a large gas debt payment by Naftogaz (1.2 percent of GDP), which was financed through the budget. In order to improve the financial situation of Naftogaz, gas prices for households were increased by 35 percent in December 2008, from about $60 to $80 per tcm (to about one third of import prices; see Box 1), while lifeline tariffs and targeted allowances protect the most vulnerable consumers.

Box 1. Recent Developments in the Gas Sector

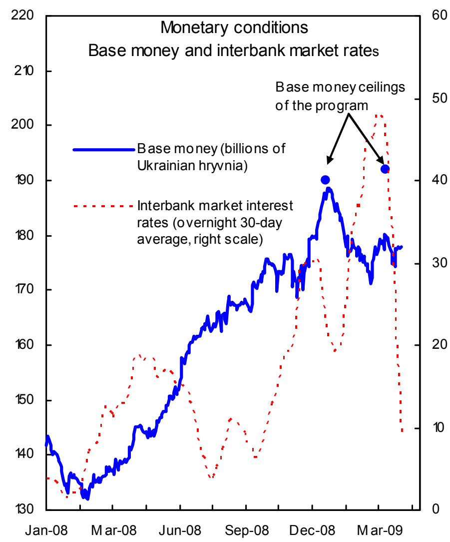
- ***Gas dispute between Russia and Ukraine.*** The dispute erupted in January, causing disruptions in the supply of Russian gas to Ukraine, as well as to the Balkans and Central Europe. It was resolved after Naftogaz repaid its outstanding debt to Gazprom, and a new ten-year gas contract was signed in early February. The contract ends Ukraine's privileged access to Russian gas, sets gas prices according to market rates (except for a one-time 20 percent discount in 2009), and eliminates the non-transparent intermediary company, RusUkrEnergo.
- ***Recent developments.*** In March, Ukraine and the EU signed a join declaration on the modernization of Ukraine's gas transit system. To obtain the associated financial support of $5.5 billion, the EU and the IFIs stressed the need for Ukraine to establish an independent gas operator and ensure transparency. On 14 April 2009, the government announced an increase in gas prices for households of 5 to 10 percent, depending on consumption level, effective in June 2009.



Sources: Ukrainian authorities; and IMF staff calculations.

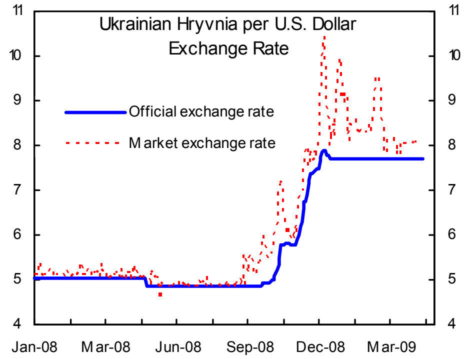
6. **The NBU has extended large-scale liquidity support to the banking system since October 2008** (Table 4). By end-March 2009, total outstanding refinance credits amounted to some 7½ percent of GDP, covering 70 percent of the deposit losses of the banking system. Refinance credits were provided for relatively long maturities (up to one year), and a significant share was provided to banks facing deposit outflows and that have now been placed under temporary administration.

7. **The monetary policy stance has been tightened.** Overnight refinance rates were increased in February to 20 percent and are now positive in real terms. The authorities have recently introduced various quantitative limits on refinancing. To discourage deposit dollarization, the NBU raised reserve requirements for foreign currency time deposits from 3 to 4 percent and for foreign currency current accounts from 5 to 7 percent. Both the end-December 2008 and end-March 2009 base money targets were met.



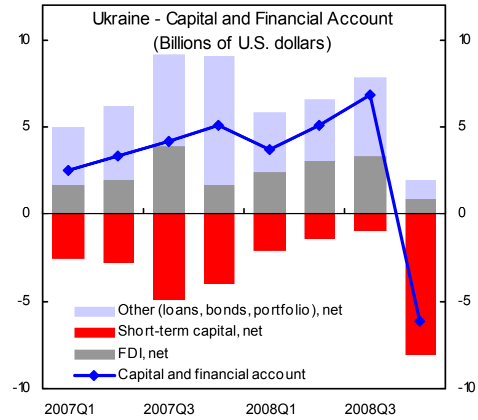
Sources: National Bank of Ukraine; and IMF staff estimates.

8. **Price pressures are easing.** Inflation has declined from 24.6 percent in September to 18 percent in March, despite the depreciation of the hryvnia since October 2008 (Figure 3). Disinflation has been driven by developments in oil and food prices, and the widening output gap. Core inflation has been stickier, but has recently also eased.



Source: National Bank of Ukraine.

9. **The current account adjusted rapidly**, with the trade deficit narrowing significantly reflecting a sharp decline in imports (Table 5, Figure 4). The exchange rate has depreciated by about 35 percent in nominal effective terms since early September 2008—and has recently shown signs of stabilization, allowing the NBU to scale back interventions since March 2009.

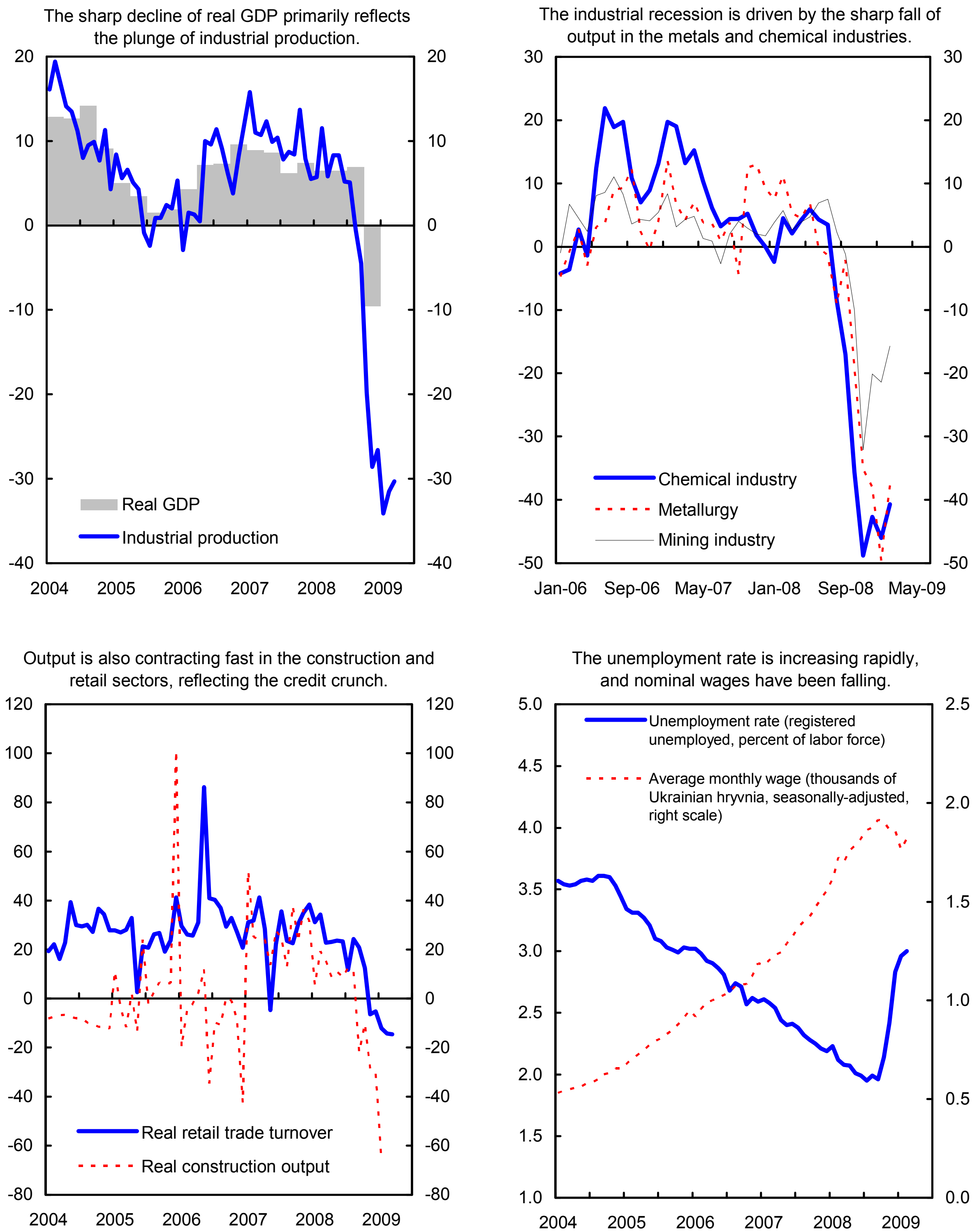


Sources: National bank of Ukraine; and IMF staff estimates.

10. **The balance of payments remains under pressure, but some mitigating factors helped keep NIR in line with program targets.** In 2008Q4, the financial account has registered large outflows of short-term capital, reflecting the conversion of hryvnia into foreign exchange cash, and net FDI fell nearly 50 percent year-on-year. These outflows have been partially offset by the rapid current account adjustment and higher-than-expected private sector debt rollover rates, limiting the drain on reserves. Rollover rates for medium- and long-term private debt are estimated to have exceeded 100 percent in 2009Q1. Foreign banks have been able to secure funding from their parents, and corporations—particularly those with related entities abroad—have been able to roll over their external obligations.

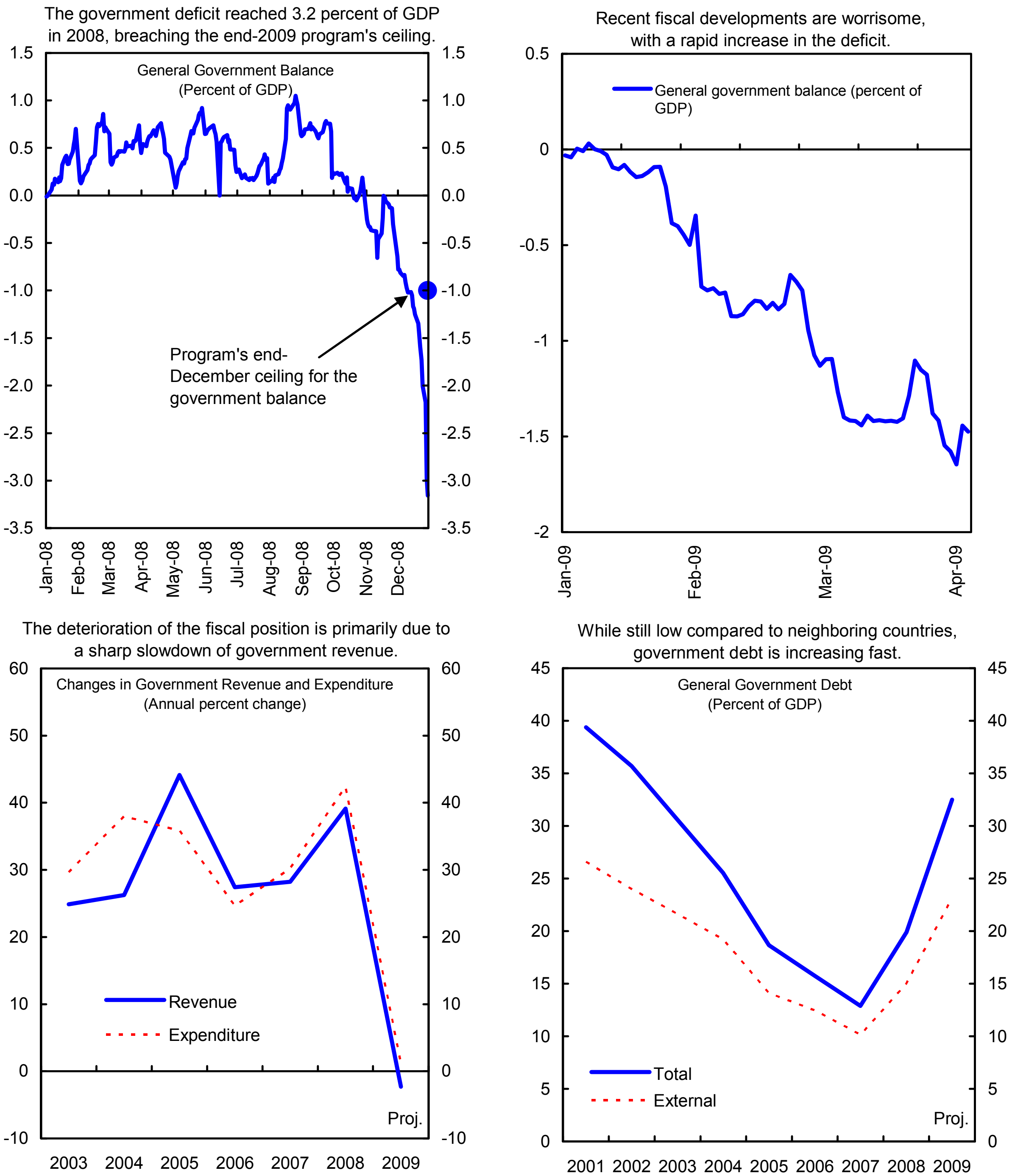
11. **The banking system has been under significant strain and prompt actions are needed to restore confidence** (Table 6, Figure 5)**.** Concerns about the stability of the banking system, imposition of controls on withdrawal of time deposits ahead of maturity date and exchange rate volatility led to the outflow of over 20 percent of deposits between October 2008 and March 2009. Reduced funding and lower demand have brought credit growth to a halt, with sharp contractions in the mortgage and consumer lending sectors. At the same time, the high proportion of foreign currency loans coupled with the sharp depreciation of the currency led to significant deterioration in the repayment of loans. In response, banks have started a major effort to restructure foreign currency-denominated loans of households and corporates, and several of the largest banks reported a positive trend in debt payments (adequate debt servicing records for the first two restructured installments). Reflecting the stabilization of the currency, deposits and loans denominated in local currency have been marginally increasing since early April. It is critical that the authorities take decisive action to restore depositors' confidence, including prompt resolution of problem banks, strengthening of the deposit insurance and an effective communication strategy.

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



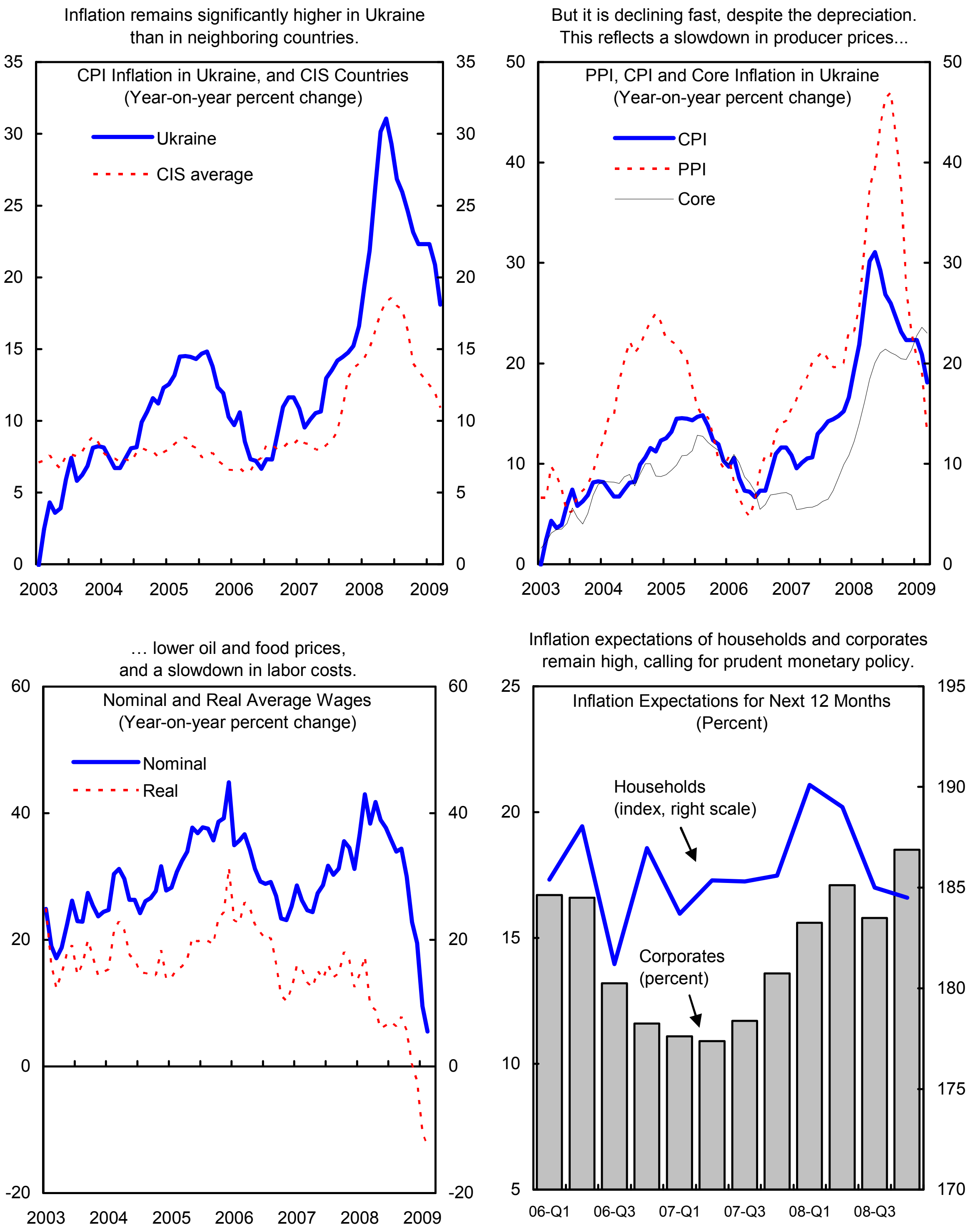
Sources: Ukrainian authorities; and IMF staff calculations.

Figure 2. Ukraine: Fiscal Indicators, 2001–09



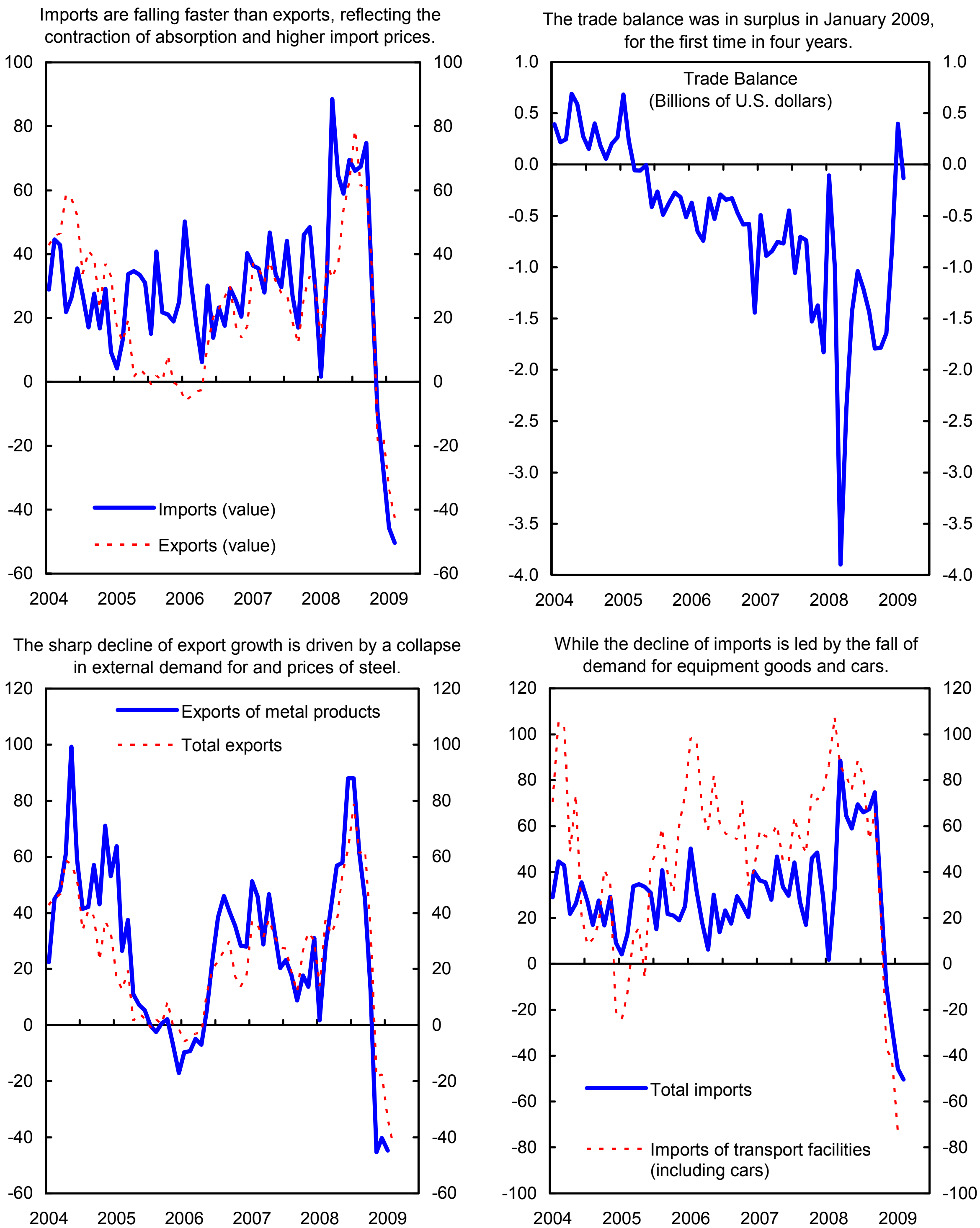
Sources: Ukrainian authorities; and IMF staff calculations.

Figure 3. Ukraine: Indicators of Inflation, 2003–09



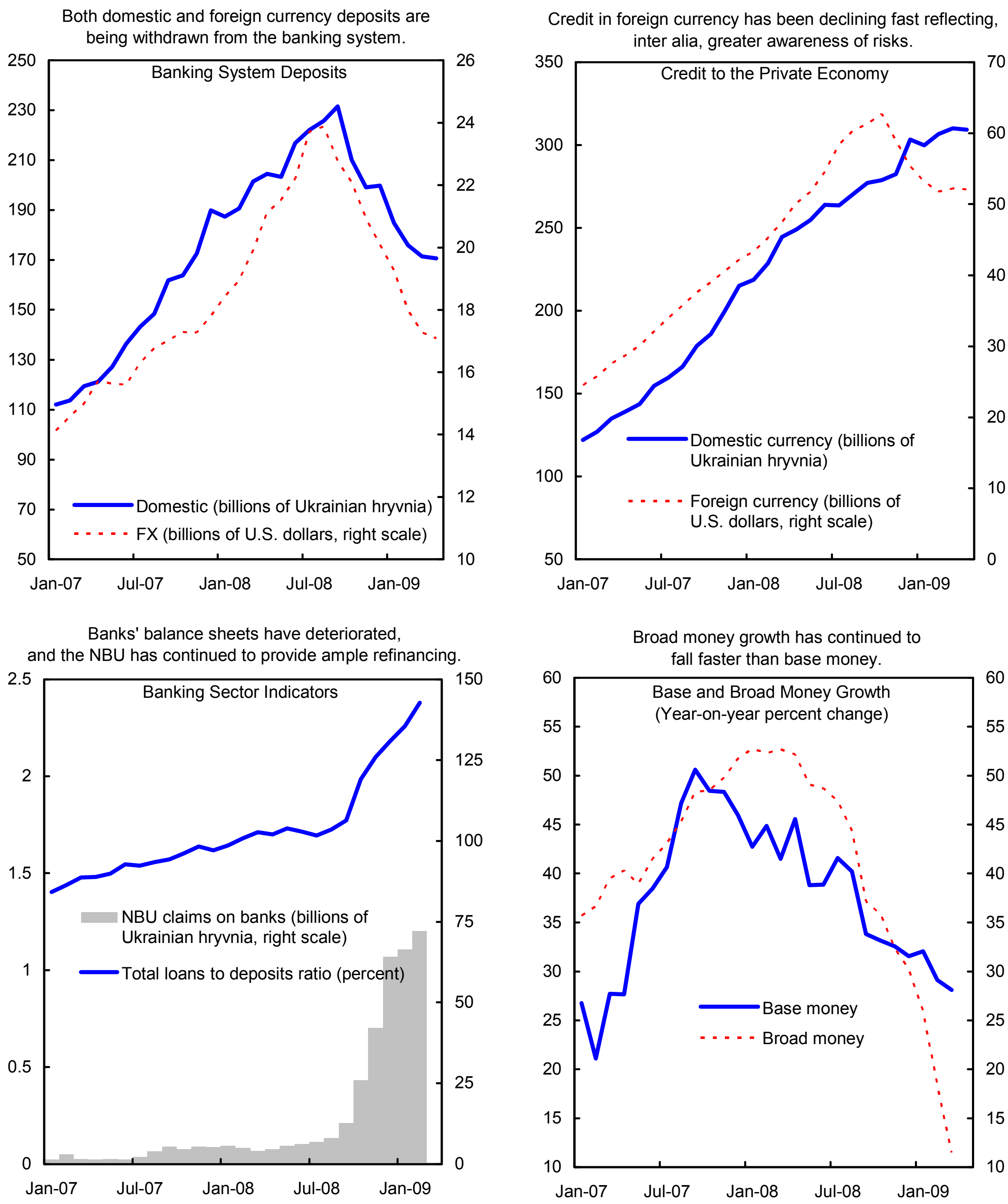
Sources: Ukrainian authorities; and IMF staff calculations.

Figure 4. 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 5. Ukraine: Banking System Indicators, 2007–09



Sources: Ukrainian authorities; and IMF staff calculations.

III. Policy Discussions

A. Macroeconomic Framework

12. **The macroeconomic framework for 2009 has been revised.**

- ***Real GDP is projected to decline by 8 percent in 2009***, compared to 3 percent initially expected in the program. A gradual recovery would start in the second half of 2009, as competitiveness gains fostered by the depreciation and somewhat higher external demand stimulate exports, while measures to restore confidence in the banking system allow a gradual resumption of credit growth.

- ***Inflation should remain on a downward path.*** The effect of the past depreciation will continue to be more than offset by the impact of a larger output gap and lower energy prices. CPI inflation is expected to reach 16 percent by end-2009—its fall in the remaining part of 2009 will be slowed by unfavorable base effects reflecting the decline of food prices in the second part of 2008—against 17 percent in the original program.

- ***Bank credit to the economy is expected to contract in real terms***, reflecting weak demand, efforts by banks to hoard liquidity, and funding constraints. Deposits are projected to increase again in the second quarter of 2009, reflecting a gradual restoration of confidence in the banking sector and resumption of credit growth in the second half of the year.

Revised Macroeconomic Framework, 2008–10

	2008	2009		2010	
	Est.	Prog.	Rev.	Prog.	Rev.
	(Percent change, unless otherwise indicated)				
GDP growth	2.1	-3.0	-8.0	3.3	1.0
Domestic demand	8.0	-12.0	-18.8	2.4	2.2
CPI (end of period)	22.3	17.0	16.0	8.0	8.0
Average real wage	6.8	-8.7	-11.2	-0.6	-2.5
REER	12.7	…	…	…	…
Current account (percent of GDP)	-7.2	-2.0	0.5	-1.7	1.2
Export volume (goods) 1/	-1.8	0.8	-8.8	10.7	5.8
Import volume (goods) 1/	16.9	-19.7	-31.8	5.0	5.6
Terms of trade (goods) 1/	8.0	-14.5	-13.6	-2.3	3.0

Sources: SSC; and IMF staff estimates and projections.
1/ For 2008, staff estimates based on balance of payments data.

- ***The current account balance is expected to swing to a small surplus in 2009,*** implying a sharper adjustment than initially envisaged. This reflects a large contraction of imports (-40 percent in nominal terms), in part resulting from lower imported gas prices than assumed in the original program ($236/tcm, against $260/tcm in the program).

- ***Against this background, the financing gap would remain close to the one identified in the original program despite more cautious assumptions for external financing.*** Notwithstanding recent positive trends (see ¶10), the revised program assumes somewhat lower rollover rates for private sector external debt in 2009 to reflect uncertainties regarding global financial markets. Under these assumptions, which will be revisited at the time of the next review, the external financing foreseen in the program would be sufficient to keep gross international reserves above 75 percent of short-term external debt and above five months of next year's imports.

Rollover of Private External Debt, 2009

Comparison with program assumptions 1/

	Rollover Rates (percent) Program	First Review
Banks	75	70
Foreign banks	95	85
Domestic banks	20	30
Corporates	95	80
Multinational	110	90
Others	90	70
Aggregate	85	75

Sources: IMF staff.

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

Gross Financing Requirements and Financing Gaps, 2006–10

(Millions of U.S. dollars)

	2006	2007	2008	2009	2010
Gross external financing requirements	26,924	40,040	55,110	61,775	59,740
Current account deficit (assumed constant from 2008)	1,617	5,272	12,933	12,933	12,933
Amortization of private sector debt	12,583	18,953	28,258	34,038	37,290
Amortization of public debt	1,692	1,538	1,193	1,948	1,080
Short-term capital outflows	11,033	14,277	12,726	12,856	8,437
Available financing	27,354	40,481	50,763	38,170	43,007
FDI	5,740	9,221	9,688	5,200	5,734
Portfolio flows	2,822	4,423	-804	320	620
Debt financing	20,680	36,254	42,759	30,418	39,850
Reserve accumulation (- denotes increase)	-1,999	-8,980	-1,080	2,232	-3,196
Current account adjustment (cumulative) 1/	0	0	0	13,528	14,387
Remaining financing gap = net use of fund resources	-430	-441	4,347	10,077	2,346
Memorandum items:					
Gross reserves	22,256	32,436	31,543	29,311	32,507
Gross reserves (percent of short-term debt)	109	110	88	76	92

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

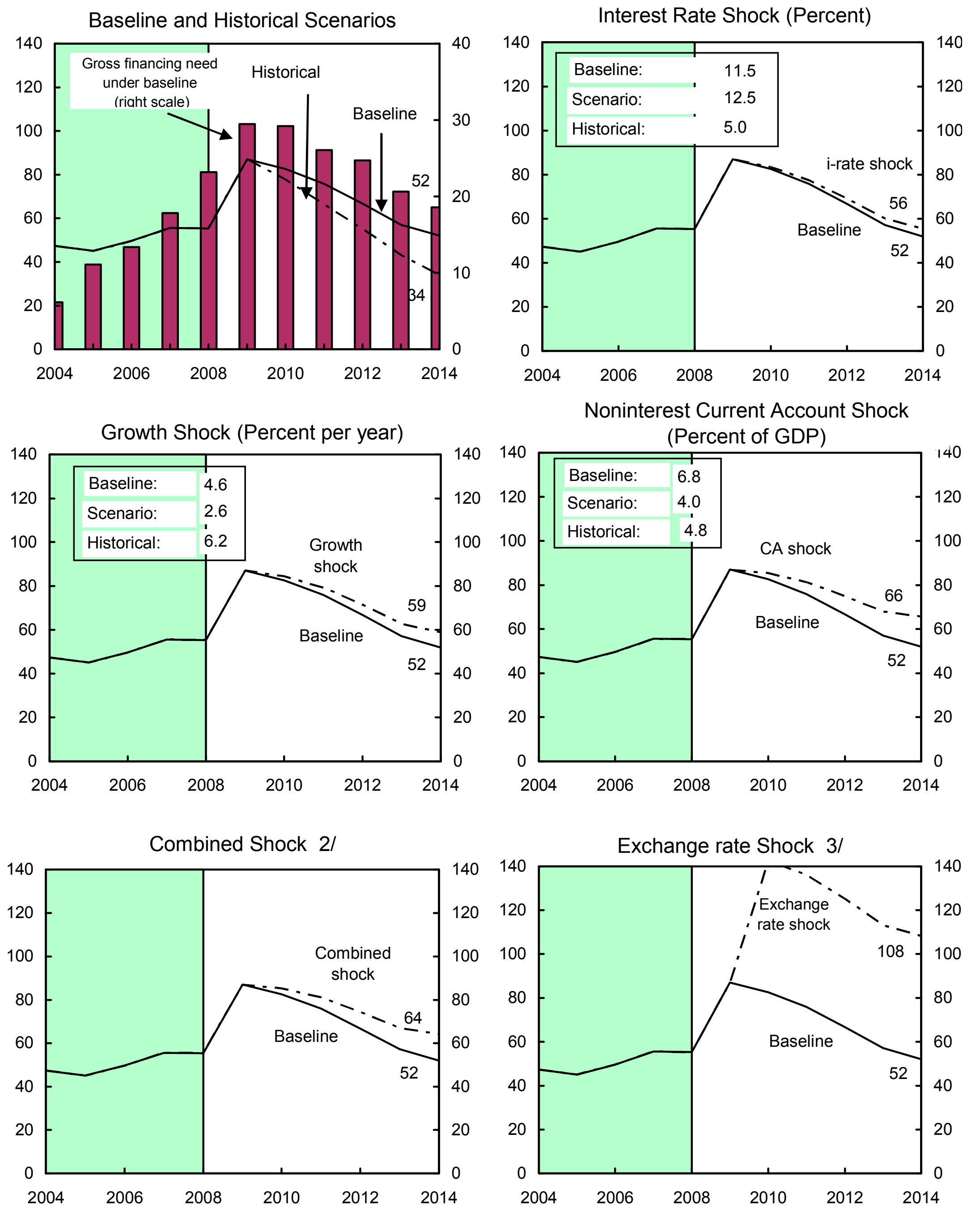
1/ Note that this is an underestimation of the actual current account adjustment since the assumption that the deficit would stay at its 2008 level already implies full adjustment to the large terms-of-trade shocks that Ukraine faces.

13. **A gradual recovery is expected in 2010** owing to the improvements in competitiveness following the adjustment in the real exchange rate, a recovery of commodity prices, and higher private investment once global financial market stress moderates (Table 7). Inflation is expected to return to the 5–7 percent range in the course of 2011, and the current account balance would remain at readily financeable levels, allowing reserves to rise.

14. **The outlook remains subject to significant downside risks.** The risk of a larger contraction of economic activity in 2009 would increase if (i) the authorities failed to restore confidence in the banking system, (ii) the process of global deleveraging in international financial markets was more pronounced than expected with adverse implications for the commitment of parent banks to their subsidiaries in Ukraine, (iii) steel prices were to decline further, or (iv) the run-up to the presidential elections gave rise to expansionary fiscal policies aggravating current imbalances.

15. **External and public debt remain sustainable under a wide range of scenarios** (Table 8 and 9, Figures 6 and 7). However, a combination of unfavorable shocks could trigger a rapid increase in both external and public debt. The baseline external DSA shows a rapidly declining external debt ratio, albeit from a high level, 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. Ukraine's low level of public debt—20 percent of GDP in 2008—provides room for the government to absorb part of bank restructuring costs without threatening fiscal sustainability. However, failure to implement the agreed consolidation measures in 2010 (pension reform, energy sector reform, reform of the simplified tax system, streamlining social privileges) would result in a higher primary deficit and pose risks to public debt sustainability.

Figure 6. Ukraine: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



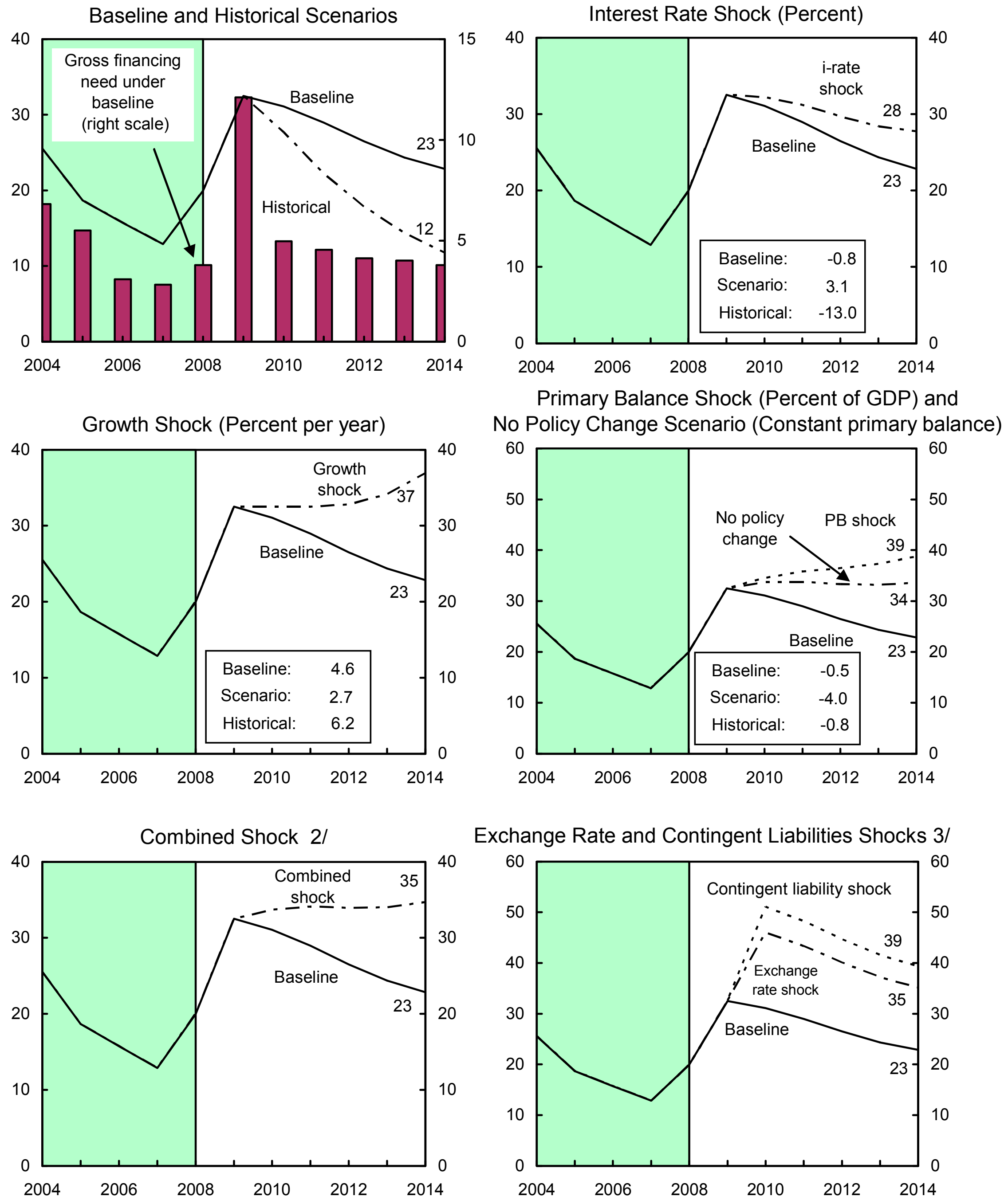
Sources: International Monetary Fund; and IMF staff estimates.

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.

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



Sources: International Monetary Fund; and 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 of GDP shock (associated with, e.g., bank restructuring costs and/or lost savings in USSRs Savings Bank) occurring in 2010.

B. Fiscal Policy

16. **Given the sharp economic contraction, the revised program relaxes the fiscal target for 2009 from balance to a deficit of 4 percent of GDP, excluding the cost of bank recapitalization** (up to 9 percent of GDP including it). Given the structure of the budget—two-thirds of government expenditure are public wages and social transfers—and the planned cuts in capital expenditures, a more ambitious deficit target would require further cuts in real incomes and social transfers. On the other hand, a higher deficit target would pose risks to medium-term fiscal sustainability. On balance, the authorities and staff concurred that, in light of Ukraine's history of low deficits and debt, a temporarily higher fiscal deficit should not be detrimental to market confidence, if accompanied by credible assurances about future adjustment.

General Government Balance, 2007–10

(Percent of GDP, unless otherwise indicated)

	2007	2008	2009	2010
			(after measures)	
Real GDP growth (percent change)	7.9	2.1	-8.0	1.0
Overall balance incl. cost of bank recapitalization	-2.0	-3.2	-9.0	-2.5
Overall balance excl. cost of bank recapitalization (principal and interest)	-2.0	-3.2	-4.0	-1.9
Overall balance excl. cost of bank recapitalization (interest only)	-2.0	-3.2	-4.5	-2.5
Corrected for one-offs 2/	-2.0	-1.3	-4.8	-2.5

Sources: IMF staff calculations.

1/ Potential growth estimates are based on a HP filter applied to quarterly data over 2004–14 (staff projection).

2/ Corrected for a one-off transfer to Naftogaz in 2008 (1.9 percent of GDP) and sale of carbon emission rights in 2009 (0.3 percent of GDP).

17. **The authorities took measures to contain the 2009 fiscal deficit to 4 percent of GDP and secure its financing (MEFP ¶8, 9).** In December, the parliament adopted a budget for 2009 that, according to staff calculations, entailed a deficit of close to 5½ percent of GDP, excluding the cost of bank recapitalization. The authorities have since then taken the following measures:

- ***To contain the deficit***, the authorities (i) increased excises on tobacco, alcohol, and diesel (½ percent of GDP); (ii) increased the domestic prices for gas, electricity and coal (¼ percent of GDP); and (iii) took measures to improve the financial condition of the Pension Fund (¼ percent of GDP). They also sold carbon emission rights (0.3 percent of GDP), and adopted a financial plan for Naftogaz, which limits the subsidy to the company to the amount planned in the budget (the plan assumes a trade credit from Gazprom to finance gas imports in 2009, which is still under negotiation).

- ***To finance the deficit***, the authorities are working toward securing an additional loan from the World Bank, a loan from the EU to modernize the natural gas infrastructure, and potential other loans from bilateral and multilateral creditors. In parallel, they are planning to bring the treasury bill auctions more in line with market conditions, accepting market yields within predefined limits, and consider re-launching their privatization program, if market conditions improve.

Fiscal Projections - State Budget
(Percent of GDP)

	2009	
	Authorities State Budget	Staff State Budget
Balance excl. cost of bank recap. (principal and interest)	-2.5	-4.0
Balance excl. cost of bank recap. (interest only)	-3.0	-4.5
Amortization	-2.6	-3.1
External	-1.2	-1.7
Domestic	-1.4	-1.5
Financing need	5.6	7.7
Financing sources	5.6	7.7
Borrowing	4.3	3.5
External	1.8	1.8
Domestic	2.5	1.7
Deposits	0.5	1.1
Privatization	0.8	0.1
Other financing	0.0	3.0
IMF	0.0	1.4
Prospective Financing	0.0	1.6

Source: IMF staff estimates.

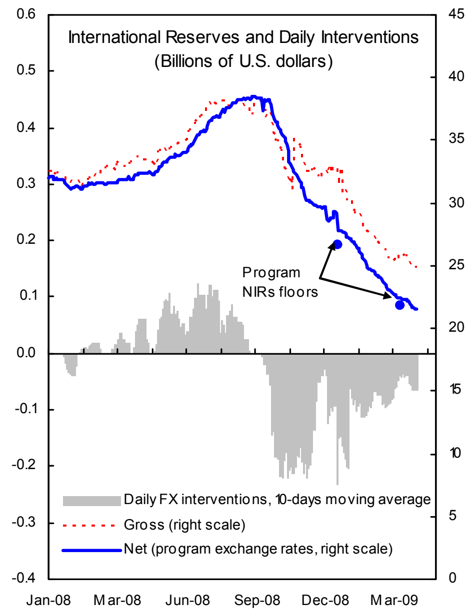
18. **Given the uncertainties, the authorities have announced contingency measures in case of revenue shortfalls (MEFP ¶10).** These measures include, but are not limited to, elimination of VAT exemptions and measures to further improve the finances of the pension fund and Naftogaz. The authorities also committed to strengthen tax administration including by designing an arrears collection plan, countering VAT fraud, revising the special tax regime for small taxpayers, and strengthening large taxpayer operations.

19. **To secure fiscal sustainability, the authorities plan to implement structural reforms before the end of 2009 (MEFP ¶11)** (Table 10). Under current policies and macroeconomic assumptions, the government deficit would reach around 4½ percent of GDP in 2010. The deficit will be kept at 2–2½ percent of GDP, a level in line with available financing and sustainability considerations. To reach this objective, the authorities have committed to reform the pension system to contain pension expenditures, which are among the highest in the world as a share of GDP. The reform will harmonize special pensions with the general system formula and set the retirement age taking into account demographic developments. In line with program objectives, the authorities plan to implement a quarterly natural gas price adjustment to bring prices to economically justified levels, with targeted transfers to protect the poor. Finally, to generate additional revenue, the authorities will take measures to strengthen the tax system and its administration, reform the simplified tax system, and streamline social privileges.

C. Monetary and Exchange Rate Policy

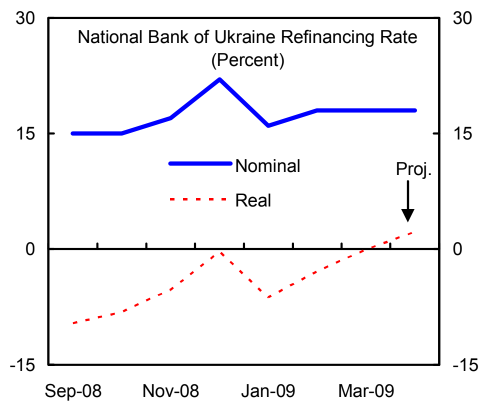
20. **The authorities are committed to implement a flexible exchange rate policy, which aligns the official exchange rate with the market rate, and is supported by base money targets and a transparent intervention strategy (MEFP ¶13, 14).** Implementation of a flexible exchange rate regime is necessary to facilitate adjustment given the economy's openness and trade pattern concentration, discourage dollarization, and achieve greater

independence of monetary policy to pursue inflation objectives. However, potentially large negative balance sheet effects associated with the large amounts of unhedged foreign currency borrowing make it important to avoid excessive exchange rate depreciation. The central bank stands ready to take action if necessary to mitigate the risk of disruptive movements in the exchange rate, including further tightening of monetary policy.



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

21. **Administrative measures to limit exchange rate flexibility will be phased out.** The authorities have taken various administrative controls to contain exchange rate volatility, including limits on the open foreign currency positions of banks and regulation that requires banks not to deviate from the average exchange rate. Most recently, the authorities have banned foreign exchange forward transactions until January 2010. These resolutions impair banks' ability to conduct their business in a profitable way and could deter foreign investors from operating in Ukraine. The authorities noted that the measures were needed on a temporary basis to contain exchange rate pressures and agreed to phase them out by end-May 2009.



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

22. **Interest rates will be raised if pressures on the exchange rate or domestic prices intensify.** A significant increase in real policy interest rates in recent months has implied a tightening of the monetary policy stance. And with inflation falling rapidly and pressures on the exchange rate easing, there is no immediate need for an increase in policy rates at the current juncture. However, it was agreed that any interruption of the downward trend in inflation would warrant a further policy tightening. Similarly, if strong pressures on the exchange rate were to reemerge, the NBU would stand ready to raise policy rates so as to avoid excessive depreciation and mitigate related upward pressures on prices.

23. **Monetary policy will remain anchored by base money targets (MEFP ¶15).** To provide for potential additional emergency liquidity support if banking problems were to intensify during the restructuring and resolution process, the staff and the authorities agreed to rephase the money targets to allow more room for maneuver in the second and third quarters of 2009.

24. **Measures are being taken to improve the operational framework for monetary policy (MEFP ¶16).**

- The authorities have finalized resolutions that specify the conditions for granting of liquidity support to solvent banks with adequate collateral and conditionality, and that clarify supervisory action and consultation procedures between the NBU and the government for decisions involving problem banks.

- To strengthen the effectiveness of monetary policy, the authorities are working on a regulation that aims to rationalize the structure of policy interest rates, ensuring that key policy rates are adequately positioned relative to each other and adjusted in parallel.

25. **The authorities have taken measures to enhance NBU independence, and are committed to take further action in this direction (MEFP ¶16, 17, 18).** They agreed that central bank independence was key to the credibility of monetary policy. In March, the parliament revoked two articles from the 2009 budget law, which had paved the way for monetization of the fiscal deficit (article 84) and government interference with NBU refinancing decisions (article 86). The removal of the articles is a significant step in enhancing the operational independence of the NBU. Going forward, the authorities are committed to strengthen the NBU's governance structure, including in particular the reform of the politicized NBU council, and accountability framework. The institutional improvements should help prepare the ground for the introduction of inflation targeting, which should replace the program's money base targets in due course.

D. Financial Sector Policy

26. **The forward-looking diagnostic studies of banks have revealed large capital deficiencies (MEFP ¶20).** The diagnostic phase of the recapitalization program has been progressing as planned.[1] The first phase is completed, with studies covering 38 banks accounting for 85 percent of total assets. Following completion of the first phase, the two state-owned banks have been recapitalized (UAH 14.4 bn or $1.8bn) in line with the diagnostic study results. For the private banks, the results revealed a capital deficiency of UAH 30.5 billion (3 percent of GDP or about $4bn). The diagnostic phase for the remaining banks in the system will be completed by May.

27. **Shareholders of most private banks, including all foreign banks, have committed to inject the necessary capital (MEFP ¶23).** Shareholders of all of the majority foreign-owned banks have committed to inject the necessary capital of about UAH 16.5 bn ($2bn) as

[1] The diagnostic studies were carried out by reputable audit firms. The methodology included the use of stress tests to provide an assessment of the banks' loss absorption capacity. Key assumptions were a 9 percent decrease in real GDP, a 25 percent drop in house prices, a 30 percent currency depreciation, and a 15 percent increase in interest rates.

have most of the domestically-owned banks UAH 5 bn ($625mn). However, for seven of the domestically-owned banks (accounting for about 15 percent of total household and corporate bank deposits), the shareholders were unable to bring in additional capital.

28. **Discussions focused on the urgent need to resolve the systemic problem banks.** Staff and the authorities agreed that due to their systemic nature, these banks should not be liquidated.[2] The Government has decided to recapitalize the systemic problem banks and the NBU and the Ministry of Finance (MoF) have agreed on all the technical documents and procedures, which include a detailed road map of joint decision making to ensure full compliance with the current legal requirements. The relevant corresponding resolutions and regulations have been prepared and approved.

29. **The resolution of the seven systemic problem banks includes taking government control and recapitalization**. It was announced that legal steps will be taken to dilute the share of existing shareholders to the fair value and that the Government will acquire at least 75 percent+1 share/voting right in each of the seven banks. The Government would own 99 percent of four of the seven banks and at least 75 percent in the remaining three banks. The NBU has initiated legally-required measures necessary to safeguard bank assets in these banks, including introduction of temporary administration. Capital needs of these banks will be calculated 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.

30. **The authorities have strengthened the institutional capacity to implement the bank recapitalization program (MEFP ¶21, 22).** A high-level council consisting of representatives from the NBU, Ministry of Finance and Ministry of Economy has been established to oversee the recapitalization of banks using public funds which is supported by a newly created recapitalization unit within the Ministry of Finance. To more effectively handle the workout of several banks that do not qualify for recapitalization through the use of public funds, the NBU is in the process of creating a Problem Bank Unit. The authorities have also put in place a loan loss classification and provisioning framework, in line with international practices, to facilitate loan restructurings.

31. **Necessary legal amendments to strengthen the bank resolution process will be submitted to parliament by end-May (MEFP ¶24).** These legal amendments will form the basis of the workouts of the non-systemically important insolvent banks. The NBU, the government and the Presidential secretariat are in the process of finalizing legal amendments

[2] Twenty-six out of 180 banks are considered systemic (representing at least 2 percent of total deposits and 1 percent of total assets). This technical definition has been agreed by the NBU, the Ministry of Finance, the World Bank and IMF staffs and is included in the NBU resolutions governing the recapitalization process. These banks have large number of depositors while the legal framework does not allow for transfer of deposits, except under insolvency procedures.

to facilitate a range of options for bank workouts, that will include write-down of shareholder capital, transfer of assets and deposits, and simplifying procedures for mergers and acquisitions. Furthermore, a legal basis for providing public funds to repay depositors in nonsystemic banks that are resolved needs to be created. Staff highlighted the importance of these legal amendments to avoid legal risks and procedural delay.

32. **The authorities have prepared a resolution on the publication of financial information on banks (MEFP ¶26).** In line with program commitments, publication of a comprehensive set of information on banks is planned to commence in September 2009.

E. Other Issues

33. **The authorities have requested waivers for nonobservance of the following continuous performance criteria (MEFP ¶14):**

- ***Exchange rate restrictions***. In January 2009, staff identified several exchange rate restrictions, some of them introduced since November 2008, that are inconsistent with the PC on nonimposition and nonintensification of restrictions on payments and transfers for current international transactions and with Ukraine's obligations under Article VIII of the Articles of Agreement. The authorities have agreed to eliminate these restrictions according to a precise timetable (Table 11).

- ***Multiple currency practices** (MCPs)*. Several MCPs have been introduced since November 2008 in breach of the performance criterion on nonintroduction and nonmodification of multiple currency practices. One of the MCPs arises from a large discrepancy between the market and the official exchange rate. The authorities have committed to issue a resolution specifying that the official exchange rate will be systematically based on the average transaction-weighted rate of the preceding day (with intra-day adjustments if necessary to keep it within 2 percent of the current day's market rate) and will eliminate this and other multiple currency practices according to a precise timetable.

- ***Import restrictions.*** The imposition of a 13 percent import surcharge on a wide range of commodities in March 2009 for balance of payments reasons constitutes nonobservance of the continuous performance criterion relating to the imposition of import restrictions. The government has notified the mission team that a cabinet of ministers resolution was adopted to restrict the surcharge to only two commodities, and has agreed to remove the surcharge fully in the near future.

IV. Program Modalities, capacity to repay, and Safeguards Assessment

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

- ***Some modifications to the program's conditionality are proposed***. In line with the recent changes to the Fund's conditionality framework, no new structural performance criteria are being proposed, and the existing ones are proposed to be converted into structural benchmarks. New structural benchmarks are proposed, notably to ensure a rapid resolution of problem banks. Prior actions for the completion of the first review include measures to enhance the independence of the NBU, to reduce the government deficit by at least 1 percent of GDP, to speed up the implementation of the bank restructuring strategy, to strengthen refinancing procedures, to tender an audit of NBU refinancing and foreign exchange operations, and to renew the authorities' commitment to a flexible exchange rate regime.

- ***The authorities have requested a rephasing of the schedule of purchases due to the delays in the completion of the first review.*** In particular, the second tranche under the program would be increased to SDR 1.9 bn (Table 12, Appendix Table I.1.).

- ***The authorities informed staff that they would like part of the disbursement for the first review (SDR 1 bn) to be channeled to the budget.*** This operation will help Ukraine meet its external public debt obligations ($1.9 bn in 2009) without having to rely on NBU financing.

35. **Staff believes that the program continues to leave Ukraine in a position to fulfill its obligations to the Fund in a timely manner** (table 12). Fund credit outstanding would peak in 2010 at 53 percent of Ukraine's gross reserves. Peak payments would be in 2012–13 at a still manageable 13 and 22 percent of gross reserves, respectively. Ukraine's past record also provides comfort as earlier loans have been completely repaid.

36. **The updated safeguards assessment of the NBU has been completed (MEFP ¶29).** The assessment concluded that aspects of the NBU's safeguards framework have been strengthened since the 2004 assessment, but it also noted that the ongoing financial crisis has significantly increased the central bank's financial and operational risks. The authorities concurred with the assessment's main findings and recommendations. In particular, the NBU will hire a specialist team from an international audit firm to conduct an independent review of its refinancing operations and currency interventions to verify compliance with all applicable resolutions and control procedures. The final report will be completed by mid-June 2009 and shared with Fund staff (this will be a prior action for the second review). Its main conclusions will be published by the authorities.

Box 2. Rationale for the Proposed Conditionality Under the Stand-By Arrangement

Monetary and Exchange Rate Policies

Exchange rate flexibility is necessary to facilitate adjustment of the economy to external shocks. For this reason, commitment to a consistent implementation of a flexible exchange rate regime and a transparent intervention strategy is made a prior action (Appendix Table I. 3., A4). It is also important that the official exchange rate be systematically aligned with the average transaction-weighted market exchange rate of the previous day (A5). The NBU should have sufficient independence in its conduct of monetary and exchange rate policies (A1 and B1), and should specify the conditions for extension of liquidity finance to solvent banks with adequate collateral and conditionality (A3). Given the financial and operational risks posed by the financial crisis to the NBU, announcing a tender for a Special Audit of NBU refinancing and foreign exchange operations is a prior action (A6 and B5).

Fiscal Policy

While government debt is low, the fiscal deficit has been deteriorating rapidly in recent months. Measures are needed to keep the government balance in line with available financing and to ensure the medium-term sustainability of government finances. For this reason, the adoption of measures reducing the 2009 deficit by at least 1 percent of GDP is a prior action (A7).

Banking Sector Issues

Decisive actions are needed to restore confidence in the banking system. Against this background, a joint NBU and Cabinet of Ministers resolution to set out the guiding principles for the bank resolution strategy is a prior action (A2). Furthermore, legislation should be amended to: (i) include definition and disclosure of ultimate controllers of banks; (ii), enable revaluation of shareholder capital, transfer of assets and liabilities without prior approval of creditors, simplifying and accelerating the process for bank mergers and acquisitions, and enabling the government to provide funds for banks under resolution by the NBU; and (iii) implement consolidated supervision and provide for supplementary supervision of financial conglomerates (B2). Measures are also needed to facilitate voluntary out-of-court rehabilitation (B3). Publication of detailed information on banks, in particular detailed balance sheets and income statements, will also be important to restore confidence (B4).

V. Staff Appraisal

37. **The worse macroeconomic outlook and strains in global financial markets pose significant challenges for Ukraine.** The economy has been hit hard by the sharp decline in steel prices and the reversal of capital flows, the economic consequences of which are magnified by existing vulnerabilities. The sharp economic downturn is weakening government revenue and puts additional stress on an already vulnerable banking system.

38. **Against this admittedly difficult background, policy implementation has been mixed.** Greater initial exchange rate flexibility has helped the economy adjust to external shocks, and progress was made in implementing the bank recapitalization program. At the same time, there have been deviations from the fiscal policy agreed in the program, the implementation of the flexible exchange rate regime has been irregular, the resolution of problem banks has been slow, and several continuous performance criteria have not been observed. These shortfalls have contributed to a delays in discussions on the first review.

39. **Strengthened policy implementation is critical to support economic activity and restore confidence:**

- ***Fiscal policy has to strike a balance between cushioning the economic downturn and preserving medium-term fiscal sustainability***. The revised program relaxes the fiscal deficit target for 2009 from balance to a deficit of 4 percent of GDP and the staff welcomes and supports the authorities' efforts to mobilize additional financing. However, given uncertainties regarding revenues, it is critical that the authorities have in place contingency measures to deal with possible shortfalls.

- ***It is critical to implement a flexible exchange rate policy, supported by base money targets and a transparent intervention strategy***. Given the openness of Ukraine's economy and the concentration of its exports, to discourage dollarization and excessive risk taking by unhedged borrowers, and to allow monetary policy to focus on inflation objectives, it is key that the hryvnia exchange rate is flexible. Staff welcomes the actions taken to align the official exchange rate with the market rate. At the same time, potentially large negative balance sheet effects associated with the large amounts of unhedged foreign currency borrowing make it important to avoid excessive exchange rate depreciation.

- ***Measures are urgently needed to restore confidence in the banking system*.** The diagnostic phase of the bank recapitalization program has advanced well, the authorities have recently placed temporary administrators in several problem banks, and all foreign banks and some domestic banks have committed to inject the necessary capital. However, for a durable restoration of banking system confidence, it is critical that resolution of systemic insolvent banks proceed swiftly, and that the next steps of the bank recapitalization program are implemented without delay. It is also important that these steps are consistently taken on the basis of transparent technical criteria. The legal amendments that the authorities have prepared to support these policies should be rapidly implemented.

40. **With inflation falling rapidly and pressures on the exchange rate easing, there is no immediate need for a tightening of monetary policy**. Monetary policy will remain anchored on base money targets. Recent amendments to the refinancing framework should help ensure that refinancing is provided to solvent banks with adequate collateral and conditionality and that consultation procedures are in place between the government and the NBU for decisions involving insolvent banks.

41. **Staff believes that the program continues to be fully financed despite the higher fiscal deficit target.** The current account has adjusted sharply, so that expected external financing remains sufficient to keep reserves at comfortable levels, while leaving some space for a larger fiscal deficit. The adequacy of external financing will be reassessed in the context of the second review.

42. **Implementation risks remain high, despite improved policy coordination.** The commitment of the authorities to their revised economic program, and recent progress on governance issues, are welcome. Nevertheless, implementation risks remain high, reflecting the uncertain economic outlook and complex political situation, especially in the run up to the Presidential elections.

43. **Staff supports the authorities' request for completion of the first review under the Stand-By Arrangement.** Implementation of policies consistent with the program is critical to help Ukraine weather the current difficulties. Given the renewed commitment of the authorities to fiscal discipline and agreed changes in program parameters, staff supports the authorities' requests for waivers for nonobservance of the performance criteria on the passage of a balanced budget for 2009 and of the end-March-2009 government deficit ceiling. Staff also supports the authorities' request for waivers for nonobservance of the continuous performance criteria, given their temporary nature and the authorities' commitment to take corrective measures according to a firm schedule, but does not recommend approval of the existing exchange restrictions and multiple currency practices for purposes of Article VIII, Section 2. Staff supports the request for a rephasing of the schedule of purchases under the arrangement.

Table 1. Ukraine: Selected Economic and Social Indicators, 2006–10 1/ 2/ 3/

	2006	2007	2008	2009	2009	2010
			Est.	Orig. Prog.	Proj. 1/	
Real economy (percent change, unless otherwise indicated)						
Nominal GDP (billions of hryvnias)	544	721	950	1,112	990	1,118
Real GDP	7.3	7.9	2.1	-3.0	-8.0	1.0
Contributions:						
Domestic demand	13.1	17.2	9.1	-14.3	-22.5	2.3
Net exports	-5.8	-9.3	-7.0	11.3	14.5	-1.3
Unemployment rate (ILO definition; percent)	6.8	6.4	6.4	9.5	9.9	9.8
Consumer prices (period average)	9.1	12.8	25.2	21.0	17.2	10.8
Consumer prices (end of period)	11.6	16.6	22.3	17.0	16.0	8.0
Nominal monthly wages (average)	29.2	29.7	33.7	10.5	4.0	8.0
Real monthly wages (average)	18.4	15.0	6.8	-8.7	-11.2	-2.5
Public finance (percent of GDP)						
Cash balance excluding bank recap. (both injection and interests) 2/	-1.4	-2.0	-3.2	0.0	-4.0	-1.9
Augmented balance, including effects of bank recapitalization	-1.4	-2.0	-3.2	-4.5	-9.0	-2.5
Privatization proceeds	0.4	0.6	0.3	0.1	0.3	0.2
Net domestic financing	-0.4	0.3	2.5	4.4	5.6	1.1
Net external financing	1.3	1.0	0.4	0.0	3.2	1.1
Public debt 3/	15.7	12.9	19.9	17.4	32.5	31.1
Of which: external debt (foreign currency denominated)	12.5	10.1	15.0	10.0	23.1	22.4
Money and credit (end of period, percent change)						
Base money	17.5	46.0	31.6	10.9	6.6	12.2
Broad money	34.5	51.7	30.2	9.4	3.8	14.0
Credit to nongovernment	70.6	74.0	72.1	-9.8	7.8	6.1
Velocity	2.1	1.8	1.8	1.9	1.9	1.8
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	-2.0	0.5	1.2
Foreign direct investment	5.3	6.4	5.4	6.8	4.6	4.6
Gross reserves (end of period, billions of U.S. dollars)	22.3	32.4	31.5	30.7	29.3	32.5
Months of next year's imports of goods and services	3.7	3.9	6.0	4.5	5.3	5.3
Debt service (percent of exports of goods and services)	5.1	4.0	2.7	4.2	5.6	4.4
Goods exports (annual volume change in percent)	2.7	3.2	-1.8	0.8	-8.8	5.8
Goods imports (annual volume change in percent)	12.5	20.3	16.9	-19.7	-31.8	5.6
Goods exports	36.1	34.8	37.7	39.9	42.2	42.0
Goods imports	40.9	42.2	47.1	46.4	45.1	43.6
Share of metals in merchandise exports (percent)	42.2	41.7	40.8	30.3	35.5	34.4
Net imports of energy (billions of U.S. dollars)	8.1	11.5	16.7	16.0	13.0	14.3
Goods terms of trade (percent change)	-0.3	9.0	8.0	-14.5	-13.6	3.0
Goods and services terms of trade (percent change)	1.5	7.4	8.8	-10.5	-9.2	5.7
Exchange rate						
Exchange rate regime	de facto peg		managed float			
Hryvnia per U.S. dollar, end of period	5.0	5.0	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	12.7	…	…	…

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 44 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 also adjusted by staff to ensure consistency with international accounting rules.

3/ Government and government-guaranteed debt, and National Bank of Ukraine debt. Excludes debts by state-owned enterprises. Debt figures do not include IMF money.

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/	16.3	2.9	2.1	3.8	12.9	47.3	14-Apr-09
EMBI secondary market spread (basis points, end of period)	264	184	172	303	2,759	2,263	14-Apr-09
Foreign currency debt rating 2/	B1	B1	B1	B1	B1	B1	14-Apr-09
Exchange rate (hryvnia per U.S. dollar, end of period)	5.3	5.1	5.1	5.1	7.7	8.4	14-Apr-09
Stock market index (PFTS)	260.1	353.0	498.9	1,174.0	301.0	314.0	14-Apr-09
Broad money to gross reserves (percent)	249.1	198.2	232.3	241.7	195.0	203.0	14-Apr-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	0.5	Proj.
Net FDI inflows (percent of GDP)	2.6	8.7	5.3	6.4	5.4	4.6	Proj.
Exports of goods and nonfactor services (percent change of U.S. dollar value)	40.8	4.8	13.2	27.4	33.8	-26.6	Proj.
Real effective exchange rate (percent change) 3/	-1.4	12.0	4.8	2.6	12.7	-21.8	Proj.
Gross international reserves (billions of U.S. dollars)	9.5	19.4	22.3	32.4	31.5	29.3	Proj.
Percent of short-term debt at remaining maturity	87.4	161.0	108.6	111.4	87.7	76.4	Proj.
Percent of short-term debt at remaining maturity and banks' FX deposits	57.3	92.0	79.0	84.7	55.9	50.2	Proj.
Net international reserves (billions of U.S. dollars)	7.9	18.2	21.4	32.0	26.8	14.5	Proj.
Total gross external debt (perrcent of GDP) 4/	46.3	45.1	49.7	55.6	55.4	87.0	Proj.
Of which: short-term external debt (original maturity, percent of total external debt)	35.0	28.2	28.4	27.7	22.4	20.3	Proj.
External debt of domestic private sector (percent of total external debt)	57.2	65.2	72.3	80.4	81.0	69.9	Proj.
External debt to foreign official sector (percent of total external debt)	17.8	16.2	11.0	7.6	6.2	7.4	Proj.
Domestically issued public debt held by nonresidents (percent of GDP)	0.6	1.5	0.6	0.6	0.3	0.7	Proj.
Total gross external debt (percent of exports of goods and nonfactor services)	74.4	87.1	106.8	124.3	116.1	158.0	Proj.
Public Sector 5/							
Overall balance (percent of GDP)	-4.4	-2.3	-1.4	-2.0	-3.2	-9.0	Proj.
Primary balance (percent of GDP)	-3.5	-1.5	-0.7	-1.5	-2.6	-7.3	Proj
Debt-stabilizing primary balance (percent of GDP) 6/	-5.9	-5.4	-2.9	-3.4	-2.8	-2.1	Proj.
Gross public sector financing requirement (percent of GDP) 7/	7.6	3.6	2.4	3.0	3.8	12.1	Proj.
Public sector gross debt (percent of GDP) 8/	25.5	18.7	15.7	12.9	19.9	32.5	Proj.
Public sector net debt (percent of GDP)	23.3	13.9	11.7	10.3	10.5	...	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 central bank.
6/ Does not include domestically issued public debt held by nonresidents.
7/ Overall balance plus debt amortization.
8/ Public debt figures exclude IMF money.

Table 3. Ukraine: General Government Finances, 2008–10 1/ 2/ 3/

	2008 Prog.		2008 Est.		2009 Prog.		2009 Budget		2009 Proj.		2010 Proj.	
	General Government	State	General Government	State	General Government	State	General Government	State	General Government	State	General Government	State
	(Millions of Ukrainian hryvnia)											
Revenue	424,931	234,353	419,669	231,686	469,048	257,825	...	238,931	410,035	230,037	482,193	271,282
Tax revenue	379,088	199,391	358,108	187,539	418,263	217,508	...	195,622	352,046	186,394	413,092	218,743
Personal income tax	47,677	0	45,896	0	52,683	0	...	0	46,732	0	58,970	0
Enterprise profit tax	48,923	48,306	47,857	47,456	47,300	46,608	...	41,936	41,066	40,648	49,051	48,578
Payroll tax	114,318	0	107,908	0	126,725	0	...	0	99,117	0	113,542	0
Property tax	6,623	0	6,681	0	7,423	0	...	0	6,147	0	7,210	0
VAT	97,610	97,610	92,083	92,083	108,835	108,835	...	94,840	90,948	90,948	108,095	108,095
Other taxes on goods and services	33,411	29,204	28,687	25,419	41,395	36,102	...	36,571	40,267	34,589	44,532	38,577
Taxes on international trade	14,432	14,432	12,303	12,303	15,678	15,678	...	12,802	10,801	10,801	11,766	11,766
Other taxes	16,094	9,839	16,694	10,279	18,224	10,285	...	9,473	16,969	9,408	19,927	11,728
Nontax, capital revenue, and grants	45,843	34,961	61,561	44,147	50,785	40,317	...	43,310	57,989	43,643	69,100	52,539
Expenditure	434,861	243,882	449,625	255,957	475,498	264,179	...	270,036	455,034	275,036	510,152	299,678
Current expenditures	380,135	207,139	392,464	215,855	420,270	228,088	...	229,159	404,831	234,159	434,865	247,673
Wages	100,189	45,597	97,702	43,380	108,190	47,534	...	45,990	104,812	45,990	113,901	49,360
Goods and services	58,523	37,385	59,470	38,500	59,112	36,703	...	42,789	60,480	42,789	61,830	43,780
Subsidies	28,947	21,235	34,376	24,815	27,163	19,224	...	10,288	20,250	10,288	13,980	2,687
Transfers	186,544	97,519	196,009	104,742	208,853	108,719	...	113,934	202,491	118,934	223,097	131,123
Interest	5,932	5,403	4,906	4,419	16,953	15,908	...	16,158	16,797	16,158	22,058	20,723
Capital spending	47,086	29,182	52,949	37,369	48,957	29,906	...	32,318	44,277	35,034	69,288	46,005
Net lending	5,570	5,491	2,811	2,732	5,571	5,484	...	5,844	5,926	5,844	6,000	6,000
Unallocated spending	2,070	2,070	1,400	0	700	700	...	2,716	0	0	0	0
Overall balance, excluding upfront recapitalization cost	-9,930	-9,530	-29,956	-24,271	-6,450	-6,354	...	-31,105	-44,999	-44,999	-27,960	-28,395
Cost of bank recapitalization: upfront cost	10,000	10,000	0	0	44,000	44,000	...	44,000	44,000	44,000	0	0
Cost of bank recapitalization: interest cost	0	0	0	0	6,450	6,450	...	4,950	4,950	4,950	6,600	6,600
Overall balance, excluding recapitalization cost (program target)	-9,930	-9,530	-29,956	-24,271	0	96	...	-26,155	-40,049	-40,049	-21,360	-21,795
Financing, excluding upfront recapitalization cost	9,930	9,530	29,956	24,271	6,450	6,354	...	31,105	44,999	44,999	27,960	28,395
External	62	-424	3,594	3,659	185	-598	...	5,878	31,251	31,251	12,888	12,888
Disbursements	2,526	2,003	6,196	6,027	9,652	8,832	...	18,808	47,621	47,621	25,650	25,650
Amortization	-2,464	-2,427	-2,602	-2,368	-9,467	-9,430	...	-12,930	-16,370	-16,370	-12,762	-12,762
Domestic, excluding upfront recapitalization cost	7,782	7,968	23,923	20,130	48,853	49,839	...	16,726	11,248	13,248	12,571	15,007
Net Borrowing, excluding upfront recapitalization cost	2,599	2,009	20,014	20,014	49,650	49,575	...	11,523	2,182	2,182	5,000	5,000
Borrowing, excluding upfront recapitalization cost	6,405	5,681	23,419	23,419	62,655	62,331	...	26,042	16,700	16,700	20,199	20,199
Amortization	-3,807	-3,672	-3,404	-3,404	-13,005	-12,755	...	-14,518	-14,518	-14,518	-15,199	-15,199
Other, including deposit finance	5,183	5,959	3,909	115	-798	263	...	5,202	9,066	11,066	7,571	10,007
Privatization	2,086	1,986	2,509	482	1,412	1,112	...	8,501	2,500	500	2,500	500

Table 3. Ukraine: General Government Finances, 2008–10 1/ 2/ 3/ (concluded)

	2008		2008		2009		2009		2009		2010	
	Prog.		Est.		Prog.		Budget		Proj.			
	General Government	State	General Government	State	General Government	State	General Government	State	General Government	State	General Government	State
	(Percent of GDP, unless otherwise indicated)											
Revenue	42.8	23.6	44.2	24.4	42.2	23.2	...	22.8	41.4	23.2	43.1	24.3
Tax revenue	38.2	20.1	37.7	19.7	37.6	19.6	...	18.7	35.6	18.8	37.0	19.6
Personal income tax	4.8	0.0	4.8	0.0	4.7	0.0	...	0.0	4.7	0.0	5.3	0.0
Enterprise profit tax	4.9	4.9	5.0	5.0	4.3	4.2	...	4.0	4.1	4.1	4.4	4.3
Payroll tax	11.5	0.0	11.4	0.0	11.4	0.0	...	0.0	10.0	0.0	10.2	0.0
Property tax	0.7	0.0	0.7	0.0	0.7	0.0	...	0.0	0.6	0.0	0.6	0.0
VAT	9.8	9.8	9.7	9.7	9.8	9.8	...	9.1	9.2	9.2	9.7	9.7
Other taxes on goods and services	3.4	2.9	3.0	2.7	3.7	3.2	...	3.5	4.1	3.5	4.0	3.5
Taxes on international trade	1.5	1.5	1.3	1.3	1.4	1.4	...	1.2	1.1	1.1	1.1	1.1
Other taxes	1.6	1.0	1.8	1.1	1.6	0.9	...	0.9	1.7	1.0	1.8	1.0
Nontax, capital revenue, and grants	4.6	3.5	6.5	4.6	4.6	3.6	...	4.1	5.9	4.4	6.2	4.7
Expenditure	43.8	24.6	47.3	26.9	42.7	23.8	...	25.8	46.0	27.8	45.6	26.8
Current expenditures	38.3	20.9	41.3	22.7	37.8	20.5	...	21.9	40.9	23.7	38.9	22.2
Wages	10.1	4.6	10.3	4.6	9.7	4.3	...	4.4	10.6	4.6	10.2	4.4
Goods and services	5.9	3.8	6.3	4.1	5.3	3.3	...	4.1	6.1	4.3	5.5	3.9
Subsidies	2.9	2.1	3.6	2.6	2.4	1.7	...	1.0	2.0	1.0	1.3	0.2
Transfers	18.8	9.8	20.6	11.0	18.8	9.8	...	10.9	20.5	12.0	20.0	11.7
Interest	0.6	0.5	0.5	0.5	1.5	1.4	...	1.5	1.7	1.6	2.0	1.9
Capital spending	4.7	2.9	5.6	3.9	4.4	2.7	...	3.1	4.5	3.5	6.2	4.1
Net lending	0.6	0.6	0.3	0.3	0.5	0.5	...	0.6	0.6	0.6	0.5	0.5
Unallocated spending	0.2	0.2	0.1	0.0	0.1	0.1	...	0.3	0.0	0.0	0.0	0.0
Overall balance, excluding upfront recapitalization cost	-1.0	-1.0	-3.2	-2.6	-0.6	-0.6	...	-3.0	-4.5	-4.5	-2.5	-2.5
Cost of bank recapitalization: upfront cost	1.0	1.0	0.0	0.0	4.0	4.0	...	4.2	4.4	4.4	0.0	0.0
Cost of bank recapitalization: interest cost	0.0	0.0	0.0	0.0	0.6	0.6	...	0.5	0.5	0.5	0.6	0.6
Overall balance, excluding recapitalization cost (program target)	-1.0	-1.0	-3.2	-2.6	0.0	0.0	...	-2.5	-4.0	-4.0	-1.9	-2.0
Financing, excluding upfront recapitalization cost	1.0	1.0	3.2	2.6	0.6	0.6	...	3.0	4.5	4.5	2.5	2.5
External	0.0	0.0	0.4	0.4	0.0	-0.1	...	0.6	3.2	3.2	1.2	1.2
Disbursements	0.3	0.2	0.7	0.6	0.9	0.8	...	1.8	4.8	4.8	2.3	2.3
Amortization	-0.2	-0.2	-0.3	-0.2	-0.9	-0.8	...	-1.2	-1.7	-1.7	-1.1	-1.1
Domestic, excluding upfront recapitalization cost	0.8	0.8	2.5	2.1	4.4	4.5	...	1.6	1.1	1.3	1.1	1.3
Net Borrowing, excluding upfront recapitalization cost	0.3	0.2	2.1	2.1	4.5	4.5	...	1.1	0.2	0.2	0.4	0.4
Borrowing, excluding upfront recapitalization cost	0.6	0.6	2.5	2.5	5.6	5.6	...	2.5	1.7	1.7	1.8	1.8
Amortization	-0.4	-0.4	-0.4	-0.4	-1.2	-1.1	...	-1.4	-1.5	-1.5	-1.4	-1.4
Other, including deposit finance	0.5	0.6	0.4	0.0	-0.1	0.0	...	0.5	0.9	1.1	0.7	0.9
Privatization	0.2	0.2	0.3	0.1	0.1	0.1	...	0.8	0.3	0.1	0.2	0.0
Financing gap	0.0	0.0	0.0	0.0	-4.0	-4.0	...	0.0	0.0	0.0	0.0	0.0
Memorandum item:												
Primary deficit excluding upfront recapitalization costs	-0.4	-0.4	-2.6	-2.1	0.9	0.9	...	-1.4	-2.8	-2.9	-0.5	-0.7
Nominal GDP (millions of hryvnias)	993,009	993,009	949,864	949,864	1,112,290	1,112,290	1,046,500	1,046,500	989,682	989,682	1,117,626	1,117,626

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

1/ Based on implementation of IMF policy advice, staff macroeconomic and revenue estimates, and IMF staff estimatesof budget transfers necessary to fill financing gaps in the pension and social funds. The aggregates for the general government cover the whole of the general government sector, including local authorities and the 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 forecast assumes a public-financed recapitalization of banks for a total amount of 54 billion hryvnias.

Table 4. Ukraine: Monetary Accounts, 2005–10 1/

	2005	2006	2007	2008	2009	2009	2010
					Orig. Prog.	Proj.	
				(Millions of hryvnias)			
Monetary Survey							
Net foreign assets	81,842	66,717	50,978	-32,332	-91,422	-116,476	-103,324
Net domestic assets	112,229	194,346	345,179	548,059	685,773	651,618	713,408
Domestic credit	144,892	247,037	436,285	776,162	669,238	889,130	950,187
Net claims on government	-7,180	-7,821	-6,658	22,274	106,301	76,253	87,324
Credit to the economy	144,277	246,156	428,347	737,273	544,386	794,962	843,846
Other claims on the economy	7,796	8,702	14,597	16,615	18,551	17,915	19,017
Other items, net	-32,663	-52,691	-91,107	-228,103	16,536	-237,512	-236,779
Broad money	194,071	261,063	396,156	515,727	594,352	535,142	610,084
Currency in circulation	60,231	74,984	111,119	154,759	172,317	161,702	179,809
Total deposits	132,914	184,430	280,154	357,768	414,708	370,119	426,490
Domestic currency deposits	87,296	114,274	190,287	200,257	241,729	190,295	210,995
Foreign currency deposits	45,617	70,155	89,867	157,512	172,979	179,824	215,495
Money market instruments	925	1,650	4,884	3,200	7,327	3,321	3,786
Accounts of the National Bank of Ukraine							
Net foreign assets	94,016	110,916	164,859	193,783	141,553	124,254	131,898
Net international reserves 2/	91,472	106,938	157,948	199,252	134,553	129,723	137,367
Net domestic assets	-11,256	-13,702	-22,958	-7,113	74,766	74,645	91,265
Net domestic credit	-10,266	-8,127	-7,856	69,023	36,467	165,826	182,502
Net claims on government	-8,149	-8,949	-6,274	10,754	-1,887	60,564	73,136
Claims on government	10,315	9,676	9,058	23,674	9,058	64,418	69,418
Liabilities government	18,464	18,625	15,332	12,920	10,945	3,854	-3,718
Net claims on the economy	76	169	165	379	165	379	379
Net claims on banks	-2,193	653	-1,748	57,890	40,189	104,883	108,987
Other items, net	-991	-5,575	-15,102	-76,136	38,299	-91,181	-91,237
Of which: revaluation	...	...	...	-67,108	-53,821	-86,279	-86,279
Base money	82,760	97,214	141,901	186,671	209,319	198,899	223,163
Currency in circulation	60,231	74,984	111,119	154,759	172,317	161,702	179,809
Banks' reserves	22,528	22,231	30,782	31,912	37,002	37,197	43,355
Cash in vault	5,178	7,150	11,352	12,779	16,797	12,617	15,691
Required reserves	9,853	4,080	9,683	13,672	10,368	17,474	16,679
Excess reserves	7,498	11,001	9,748	5,461	9,838	7,106	10,985
Deposit Money Banks							
Net foreign assets	-12,175	-44,199	-113,882	-226,116	-232,975	-240,731	-235,222
Net domestic assets	144,919	228,433	393,620	583,320	647,683	610,850	661,712
Domestic credit	169,322	268,275	459,600	721,701	666,294	757,486	808,418
Net claims on government	969	1,128	-384	11,520	108,188	15,689	14,189
Credit to the economy	144,129	245,973	428,146	736,840	544,185	794,529	843,413
Other claims on the economy	7,796	8,702	14,597	16,615	15,108	14,954	16,449
Banks' reserves	22,528	22,231	30,782	31,912	37,002	37,197	43,355
Other items, net	-24,402	-39,842	-65,981	-138,381	-18,612	-146,636	-146,706
Banks' liabilities	132,745	184,234	279,738	357,204	414,708	370,119	426,490
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	10.9	6.6	12.2
Broad money	54.4	34.5	51.7	30.2	9.4	3.8	14.0
Credit to the economy	61.8	70.6	74.0	72.1	-9.8	7.8	6.1
				(Ratio)			
Velocity of broad money 3/	2.27	2.08	1.80	1.84	1.87	1.85	1.83
Money multiplier	2.34	2.69	2.79	2.76	2.84	2.69	2.73
				(Percent)			
Foreign currency loans to total loans	43.2	49.4	49.8	58.9	60.0	44.7	41.0
Foreign currency deposits to total deposits	34.3	38.0	32.1	44.0	41.7	48.6	50.5

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 5. 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
			Orig. Prog.			Proj.			
Current account balance	-5,272	-12,933	-2,703	595	1,454	-1,232	-1,589	-2,177	-3,149
Merchandise trade balance	-10,572	-16,934	-8,725	-3,311	-1,930	-3,812	-4,933	-5,619	-6,475
Exports	49,840	67,717	54,201	48,198	52,211	56,967	61,819	67,124	72,694
Imports	-60,412	-84,651	-62,926	-51,509	-54,141	-60,779	-66,752	-72,743	-79,169
Services (net)	2,420	2,414	5,419	2,968	3,811	3,604	4,932	4,838	4,834
Receipts 2/	14,161	17,895	17,072	14,664	15,956	16,682	18,802	19,784	20,839
Payments	-11,741	-15,481	-11,653	-11,696	-12,145	-13,078	-13,870	-14,946	-16,005
Income (net)	-659	-1,540	-3,606	-2,329	-3,806	-4,629	-5,476	-5,603	-6,065
Of which: interest on public debt 3/	-1,019	-1,134	-1,555	-1,554	-1,907	-1,981	-1,958	-1,673	-1,387
Current transfers (net)	3,539	3,127	4,209	3,266	3,378	3,605	3,889	4,207	4,557
Financial and capital account	15,130	9,524	-8,092	-12,904	-604	3,498	8,128	10,057	11,424
Direct investment and capital transfers (net)	9,221	9,688	9,204	5,200	5,734	7,219	8,152	8,680	9,035
Portfolio investment (excluding government bonds)	4,423	-804	614	320	620	1,020	2,220	2,920	2,920
Bonds and medium and long-term loans (net)	15,763	13,308	-5,386	-5,568	1,480	1,391	2,757	2,987	4,209
Private sector loans	13,931	13,535	-5,380	-8,257	-457	443	1,243	2,043	2,043
Bonds and loans (official)	1,832	-227	-6	2,689	1,937	947	1,514	943	2,166
Of which: disbursements	4,244	2,926	1,351	4,548	3,017	2,329	2,316	2,731	2,874
Repayments 2/ 3/	-2,412	-3,153	-1,358	-1,858	-1,080	-1,382	-802	-1,787	-707
Of which: foreign currency	1,654	34	119	2,542	1,770	670	1,236	667	1,892
Domestic currency	178	-261	-125	148	167	277	277	277	275
Short-term capital (net)	-14,277	-12,668	-12,523	-12,856	-8,437	-6,132	-5,000	-4,529	-4,740
Errors and omissions	-437	200	0	0	0	0	0	0	0
Overall balance	9,421	-3,209	-10,795	-12,309	850	2,266	6,539	7,880	8,275
Available financing	9,421	-3,209	-10,795	-12,309	850	2,266	6,539	7,880	8,275
Gross official reserves (- is increase)	-8,980	-1,080	718	2,232	-3,196	-2,266	-2,335	-11	-3,876
Net use of IMF resources	-441	4,347	10,077	10,077	2,346	0	-4,203	-7,869	-4,399
Memorandum items:									
Total external debt 3/	79,564	99,434	106,171	99,294	102,643	104,328	103,749	100,116	101,221
Total external debt (percent of GDP)	55.6	55.4	78.2	87.0	82.6	75.9	66.7	57.1	52.0
Current account (percent of GDP)	-3.7	-7.2	-2.0	0.5	1.2	-0.9	-1.0	-1.2	-1.6
Excluding transfers	-6.2	-8.9	-5.1	-2.3	-1.5	-3.5	-3.5	-3.6	-4.0
Debt service ratio (percent of exports of goods and services) 2/ 3/	4.0	2.7	4.2	5.6	4.4	4.6	8.6	13.0	6.9
Gross international reserves (end of period) 4/	32,436	31,543	30,727	29,311	32,507	34,773	37,109	37,119	40,996
Months of next year's imports of goods and services	3.9	6.0	4.5	5.3	5.3	5.2	5.1	4.7	4.8
Over next year's official debt service	7.0	9.0	8.9	9.8	9.7	5.0	3.3	5.7	...
Merchandise export values (percent change)	28.0	35.9	-18.5	-28.8	8.3	9.1	8.5	8.6	8.3
Merchandise import values (percent change)	36.9	40.1	-25.3	-39.2	5.1	12.3	9.8	9.0	8.8
Merchandise export volume (percent change)	3.2	-1.8	0.8	-8.8	5.8	6.2	5.7	5.9	5.9
Merchandise import volume (percent change)	20.3	16.9	-19.7	-31.8	5.6	7.3	6.0	5.9	6.0
Goods terms of trade (percent change)	9.0	8.0	-14.5	-13.6	3.0	-2.0	-0.9	-0.4	-0.4
Goods and services terms of trade (percent change)	7.4	8.8	-10.5	-9.2	5.7	-0.6	0.0	0.4	0.0

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 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.
Ownership									
Number of banks 1/	173	173	174	175	176	178	184	184	185
Private	171	171	172	173	174	176	182	182	183
Domestic	131	129	128	126	127	127	132	129	131
Foreign	40	42	44	47	47	49	50	53	52
Of which: 100% foreign-owned	18	17	16	17	17	18	18	17	17
State-owned	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
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
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
Number of bank with assets less than $150 million	113	100	97	85	86	83	81	101	106
Capital Adequacy									
Regulatory capital to risk-weighted assets	14.0	14.0	13.9	13.9	13.3	13.4	13.6	14.0	15.35
Capital to total assets	12.9	12.4	12.5	12.5	13.1	12.9	13.0	14.0	…
Asset Quality									
Credit growth (year-over-year)	73.0	75.6	75.1	74.1	76.2	64.1	54.1	23.5	…
Credit to GDP ratio	47.7	51.6	55.6	60.1	62.7	60.8	63.1	83.0	…
Change of loan to GDP ratio (percentage points)	13.3	14.3	14.6	14.9	15.0	9.2	7.5	23.0	…
NPLs to total loans 2/	17.6	16.5	14.8	13.2	13.1	13.6	14.5	17.4	24
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
Specific provisions to total loans	4.7	4.7	4.5	4.2	4.1	4.1	4.3	6.1	8.6
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	…
Deposits in foreign currency to total deposits	38.8	36.5	34.6	32.1	33.1	32.5	31.8	44.0	…
Foreign currency loans to foreign currency deposits	183.7	206.0	220.8	237.2	238.8	245.5	269.2	275.5	…
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	…
Banks net foreign assets to capital	-100.5	-127.1	-137.7	-147.1	-143.8	-143.2	-160.7	...	...
Total foreign currency assets (including loans) to total foreign currency Liabilities (including deposits)	108.3	106.4	107.6	105.3	106.3	107.7	107.5	...	...
Total short-term foreign currency assets (including loans) to total short-term foreign currency liabilities (including deposits)	149.7	129.7	131.5	115.6	130.7	133.6	158.5	...	...
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
Customer deposits to total loans to the economy	71.2	67.9	67.2	65.3	62.4	61.8	59.8	48.5	…
Long-term assets to long-term liabilities	91.0	93.4	94.7	95.3	93.7	93.5	92.3	92.3	…
Short-term assets to short-term liabilities	118.2	112.9	110.7	110.0	114.2	114.2	119.4	119.4	…
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
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
Net interest margin to total assets	4.9	4.9	4.9	5.0	4.8	5.0	5.2	5.3	6.6
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
Between loans and deposits in foreign currency	5.6	5.5	5.5	4.9	5.2	8.3	6.3	4.4	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
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
Number of banks not complying with banking regulations									
Not meeting capital adequacy requirements for Tier I capital	0	0	1	0	0	0	0	2	8
Not meeting prudential regulations	0	1	1	1	2	1	2	16	23
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/ 2/ 3/

	2005	2006	2007	2008	2009	2009	2010	2011	2012	2013	2014
				Est.	Orig. Prog.	Proj.					
Output and prices											
Nominal GDP (billions of hryvnias)	441	544	721	950	1112	990	1118	1240	1402	1582	1769
Real GDP growth (percent change)	2.7	7.3	7.9	2.1	-3.0	-8.0	1.0	4.3	5.8	5.7	6.0
Real domestic demand growth (percent change)	15.3	13.8	16.6	8.0	-12.0	-18.8	2.2	5.6	5.7	6.3	6.4
Consumer prices (percent change; end of period)	10.3	11.6	16.6	22.3	17.0	16.0	8.0	6.0	5.1	5.1	5.0
Consumer prices (percent change; average)	13.5	9.1	12.8	25.2	21.0	17.2	10.8	7.0	5.5	5.1	5.0
Wages											
Minimum wage (percent change; average)	39.3	21.4	17.9	23.8	16.7	18.1	12.5	12.0	11.0	10.5	10.5
Nominal monthly wages (average)	36.7	29.2	29.7	33.7	10.5	4.0	8.0	10.5	10.0	10.0	10.5
Real monthly wages (average)	20.4	18.4	15.0	6.8	-8.7	-11.2	-2.5	3.3	4.3	4.7	5.2
Public finances (percent of GDP)											
Augmented balance, including effects of banks recap. 2/	-2.3	-1.4	-2.0	-3.2	-4.5	-9.0	-2.5	-2.4	-2.2	-2.1	-2.0
Balance excl. banks recap. (upfront cost and interests)	-2.3	-1.4	-2.0	-3.2	0.0	-4.0	-1.9	-1.9	-1.8	-1.7	-1.6
Revenue and grants	41.8	43.7	41.8	44.2	42.2	41.4	43.0	43.0	43.0	43.0	43.0
Expenditure and net lending (cash basis)	44.1	45.1	43.8	47.3	42.2	45.5	44.9	44.9	44.7	44.6	44.6
Privatization receipts	5.0	0.4	0.6	0.3	0.1	0.3	0.2	0.2	0.2	0.2	0.1
Net domestic financing	-3.3	-0.4	0.3	2.5	4.4	5.6	1.1	1.5	1.4	1.2	1.1
Net external financing	0.6	1.3	1.0	0.4	0.0	3.2	1.1	0.7	0.7	0.7	0.7
Public debt (in percent of GDP; end of period) 3/	18.7	15.7	12.9	19.9	17.4	32.5	31.1	29.0	26.5	24.3	23.3
Domestic	4.6	3.3	2.8	4.9	7.4	9.4	8.7	8.3	7.7	7.1	7.1
External (foreign currency denominated)	14.1	12.5	10.1	15.0	10.0	23.1	22.4	20.7	18.8	17.2	16.2
Money and credit											
Base money (percent change, end of period)	53.9	17.5	46.0	31.6	10.9	6.6	12.2	11.4	13.4	12.8	11.1
Credit to nongovernment (percent change, end of period)	61.8	70.6	74.0	72.1	-9.8	7.8	6.1	3.4	13.4	13.3	11.5
Share of fx credit in total credit	43.2	49.4	49.8	58.9	60.0	44.7	41.0	44.7	45.3	45.9	45.9
External sector											
Current account balance (percent of GDP)	2.9	-1.5	-3.7	-7.2	-2.0	0.5	1.2	-0.9	-1.0	-1.2	-1.6
Total external debt (percent of GDP)	45.1	49.7	55.6	55.4	78.2	87.0	82.6	75.9	66.7	57.1	52.0
Goods exports, value (percent change)	4.8	11.2	28.0	35.9	-18.5	-28.8	8.3	9.1	8.5	8.6	8.3
Goods imports, value (percent change)	21.8	22.1	36.9	40.1	-25.3	-39.2	5.1	12.3	9.8	9.0	8.8
Foreign direct investment (percent of GDP)	8.7	5.3	6.4	5.4	6.8	4.6	4.6	5.3	5.2	5.0	4.6
Gross official reserves (end of period)											
Billions of U.S. dollars	19.4	22.3	32.4	31.5	30.7	29.3	32.5	34.8	37.1	37.1	41.0
Months of imports of goods and services	4.4	3.7	3.9	6.0	4.5	5.3	5.3	5.2	5.1	4.7	4.8
External debt service (percent of exports of goods and services	4.9	5.1	4.0	2.7	4.2	5.6	4.4	4.6	8.6	13.0	6.9
Hryvnia per U.S. dollar (end of period)	5.0	5.0	5.0	7.7	...	...	...	...	...	...	...
Goods terms of trade (percent change)	6.1	-0.3	9.0	8.0	-14.5	-13.6	3.0	-2.0	-0.9	-0.4	-0.4
Goods and services terms of trade (percent change)	4.9	1.5	7.4	8.8	-10.5	-9.2	5.7	-0.6	0.0	0.4	0.0
Savings-investment balance (percent of GDP)											
Foreign savings	-2.9	1.5	3.7	7.2	2.0	-0.5	-1.2	0.9	1.0	1.2	1.6
Gross national savings	25.6	23.3	24.5	21.6	21.2	26.6	25.8	24.2	24.7	25.5	25.4
Nongovernment	25.8	22.4	23.9	22.3	18.6	30.0	27.2	25.4	25.7	26.4	26.9
Government	-0.3	0.9	0.7	-0.7	2.6	-3.4	-1.3	-1.3	-1.1	-0.9	-1.5
Gross investment	22.6	24.8	28.2	28.8	23.2	26.1	24.7	25.0	25.7	26.7	27.0
Nongovernment	20.6	22.5	25.6	26.4	20.6	24.9	22.5	22.4	23.0	24.5	24.9
Government	2.0	2.2	2.6	2.5	2.6	1.2	2.2	2.7	2.7	2.2	2.0

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 54 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 also adjusted by staff to ensure consistency with international accounting rules.

3/ Government and government-guaranteed debt, and National Bank of Ukraine debt. Excludes debts by state-owned enterprises. Debt figures do not include IMF money.

Table 8. 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	47.3	45.1	49.7	55.6	55.4	**87.0**	**82.6**	**75.9**	**66.7**	**57.1**	**52.0**	**-5.8**
Change in external debt	-0.2	-2.3	4.6	5.9	-0.2	31.6	-4.4	-6.7	-9.1	-9.6	-5.1	
Identified external debt-creating flows (4+8+9)	-27.3	-26.6	-16.3	-19.0	-8.7	1.9	-7.4	-8.5	-9.9	-8.7	-8.2	
Current account deficit, excluding interest payments	-11.9	-4.6	-0.8	2.2	5.4	-8.0	-8.9	-7.1	-6.9	-5.9	-5.1	
Deficit in balance of goods and services	-7.7	-0.8	2.8	5.7	8.1	0.3	-1.5	0.2	0.0	0.4	0.8	
Exports	63.6	51.5	46.5	44.7	47.7	55.1	54.9	53.6	51.9	49.6	48.0	
Imports	56.0	50.7	49.4	50.4	55.8	55.4	53.4	53.7	51.9	50.0	48.9	
Net non-debt creating capital inflows (negative)	-5.8	-11.9	-8.6	-10.5	-4.7	-4.5	-5.5	-6.2	-7.0	-6.6	-6.7	
Automatic debt dynamics 1/	-9.6	-10.1	-6.8	-10.7	-9.5	14.4	6.9	4.8	4.0	3.8	3.6	
Contribution from nominal interest rate	1.3	1.6	2.3	1.5	1.8	7.5	7.7	8.0	7.9	7.2	6.7	
Contribution from real GDP growth	-4.4	-0.9	-2.6	-3.0	-0.9	7.0	-0.8	-3.2	-3.9	-3.4	-3.1	
Contribution from price and exchange rate changes 2/	-6.4	-10.8	-6.5	-9.2	-10.3	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	27.0	24.3	20.8	24.9	8.5	29.7	3.1	1.8	0.8	-0.9	3.0	
External debt-to-exports ratio (percent)	74.4	87.5	106.8	124.3	116.1	158.0	150.6	141.7	128.7	115.2	108.2	
Gross external financing need (billions of U.S. dollars) 4/	4.0	9.6	14.4	25.5	41.7	33.6	36.3	35.9	38.4	36.2	36.2	
Percent of GDP	6.2	11.1	13.4	17.8	23.2	29.5	29.2	26.1	24.7	20.6	18.6	
Scenario with key variables at their historical averages 5/						**87.0**	**77.7**	**66.3**	**55.2**	**43.1**	**34.0**	**-7.8**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (percent)	12.1	2.6	7.3	7.9	2.1	-8.0	1.0	4.3	5.8	5.7	6.0	
GDP deflator in U.S. dollars (change in percent)	15.5	29.4	16.9	22.9	22.9	-30.9	7.8	6.1	6.9	6.7	4.8	
Nominal external interest rate (percent)	3.4	4.5	6.5	3.9	4.1	8.6	9.6	10.7	11.8	12.1	13.0	
Growth of exports (U.S. dollar terms, percent)	42.6	7.5	13.2	27.4	33.8	-26.6	8.4	8.0	9.5	7.8	7.6	
Growth of imports (U.S. dollar terms, percent)	31.3	20.4	22.0	35.4	38.8	-36.9	4.9	11.4	9.2	8.8	8.5	
Current account balance, excluding interest payments	11.9	4.6	0.8	-2.2	-5.4	8.0	8.9	7.1	6.9	5.9	5.1	
Net non-debt creating capital inflows	5.8	11.9	8.6	10.5	4.7	4.5	5.5	6.2	7.0	6.6	6.7	

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 $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) 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 9. 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	**32.5**	**31.1**	**29.0**	**26.5**	**24.3**	**22.9**	**-1.1**
Of which: foreign-currency denominated	19.2	14.1	12.5	10.1	15.0	23.1	22.4	20.7	18.8	17.2	16.2	
Change in public sector debt	-5.1	-6.9	-2.9	-2.9	7.1	12.6	-1.4	-2.1	-2.5	-2.1	-1.5	
Identified debt-creating flows (4+7+12)	-5.6	-9.0	-2.3	-2.6	4.0	7.9	-1.6	-0.8	-1.3	-1.1	-0.8	
Primary deficit	3.5	1.5	0.7	1.5	2.6	2.8	0.5	0.5	0.5	0.5	0.5	
Revenue and grants	37.1	41.8	43.7	41.8	44.2	41.4	43.0	43.0	43.0	43.0	43.0	
Primary (noninterest) expenditure	40.6	43.3	44.5	43.3	46.8	44.3	43.5	43.5	43.5	43.5	43.5	
Automatic debt dynamics 2/	-6.0	-5.6	-2.7	-3.5	1.6	0.9	-1.9	-1.1	-1.6	-1.5	-1.1	
Contribution from interest rate/growth differential 3/	-6.0	-4.8	-2.7	-3.5	-2.6	0.9	-1.9	-1.1	-1.6	-1.5	-1.1	
Of which contribution from real interest rate	-3.1	-4.3	-1.6	-2.6	-2.4	-0.6	-1.6	0.1	-0.1	-0.1	0.2	
Of which contribution from real GDP growth	-2.9	-0.5	-1.1	-0.9	-0.2	1.5	-0.3	-1.2	-1.5	-1.3	-1.3	
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	4.2	-0.2	-0.2	-0.2	-0.2	-0.1	
Privatization receipts (negative)	-3.1	-5.0	-0.4	-0.6	-0.3	-0.3	-0.2	-0.2	-0.2	-0.2	-0.1	
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	4.4	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	4.6	0.1	-1.3	-1.2	-1.0	-0.7	
Public sector debt-to-revenue ratio 1/	68.8	44.6	36.0	30.8	45.1	78.5	72.3	67.4	61.6	56.7	53.2	
Gross financing need 6/	6.8	5.5	3.1	2.8	3.8	12.1	5.0	4.6	4.1	4.0	3.8	
Billions of U.S. dollars	4.4	4.7	3.3	4.0	6.8	13.8	6.2	6.3	6.4	7.1	7.4	
Scenario with key variables at their historical averages 7/						**32.5**	**27.7**	**22.2**	**17.8**	**14.4**	**11.7**	**-2.1**
Scenario with no policy change (constant primary balance) in 2009–14						**32.5**	**33.7**	**33.8**	**33.4**	**33.2**	**33.6**	**-1.6**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (percent)	12.1	2.7	7.1	7.9	2.1	-8.0	1.0	4.3	5.8	5.7	6.0	
Average nominal interest rate on public debt (percent) 8/	3.9	3.8	4.2	4.3	5.3	8.9	6.9	6.8	6.7	6.6	6.6	
Average real interest rate (nominal rate minus change in GDP deflator, percent)	-11.2	-20.8	-9.5	-19.9	-23.8	-4.4	-5.4	0.5	-0.1	-0.1	1.1	
Nominal appreciation (increase in U.S. 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	13.3	12.2	6.3	6.8	6.7	5.6	
Growth of real primary spending (deflated by GDP deflator, percent)	20.2	9.6	9.9	5.0	10.4	-13.0	-0.7	4.3	5.8	5.7	6.0	
Primary deficit	3.5	1.5	0.7	1.5	2.6	2.8	0.5	0.5	0.5	0.5	0.5	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

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 10. Ukraine: Structural Reforms

Areas	Main Achievements since 2000	Key Outstanding Reforms 1/
Business climate	• Leveled playing field by eliminating tax preferences (2004-05). • Reviewed over 9,000 business regulations and repealed and amended nearly 5,000 (2005-06) • Adopted Joint Stock Company Law (2008.	• Abolish anachronistic Economic Code and improve the market-oriented Civil Code. • Amend legislation on protection from unfair competition. • Adopt International Accounting Standards (IAS) for large corporates. • Lift the moratorium for the resale of agricultural land; remove current restrictions in Land Code on non-agricultural land ownership; establish registries for real estate and agricultural land property rights. • Implement reform of the court system to ensure independence and impartiality. • Re-launch transparent privatization program.
Trade policy	• Received market economy status from the EU and the United States (2006). • Slashed average import tariffs from 7.7 to 5.1 percent (2005). • Completed the main steps leading to WTO accession (2007-08).	• Progress in the negotiations of a EU-Ukraine trade agreement.
Energy sector	• Eliminated the culture of non-payment in the energy sector (2000-2002) • Adopted legislation to mutually offset and restructure debts in the energy sector (2005) • Adopted cash payments for gas transits through Ukraine, rather than payments in kind (2005).	• Implement strategy to make Naftogaz internationally competitive. • Implement Ukraine's coal mine restructuring plan. • Enhance independence of National Electricity Regulatory Commission. • Stimulate energy savings by allowing prices to reflect costs.
Fiscal-structural reforms	• Adopted a budget code establishing a solid legal framework for budget management and many of the budget execution and reporting functions (2001)	• Implement a Pension Reform to make the system sustainable in the medium and long run. • Implement comprehensive reform for State Tax Administration. • Bring the State Tax Administration and Customs under the control of the Ministry of Finance.* • Implement a medium-term budget framework. • Bring public procurement legislation in line with EU legislation. • Set up a monitoring and oversight system for financial risks in state-owned enterprises. • Reform the system of unfunded social mandates and replace it with a targeted social protection system.

1/ Measures include those listed in the Ukraine-EU Action Plan, and World Bank, OECD, and Fund recommendations. The table does not include measures on the financial sector, which are covered separately.

Table 11. Ukraine: Timetable for Elimination of Exchange Restrictions and Multiple Currency Practices

Measure	Date introduced	Status Under Article VIII	Schedule for elimination/ corrective action	Recommendation for approval under Article VIII	Recommendation for waiver of nonobservance of the PCs on exchange measures
1. Prohibition on purchase of foreign exchange for settlement on imports that do not enter Ukraine and are designated for further resale to non-residents.	December 4, 2008, NBU Resolution 413	Exchange restriction	The restriction is temporary and is expected to be lifted by end-April 2009	Approval not recommended	Waiver recommended as the measure is temporary
2. Limit in an amount equivalent of UAH 75.000 per month on purchase of foreign exchange on the interbank market and on transfers for non-trade transactions by resident and non-resident individuals.	October 29, 2008, NBU Resolution 340	Exchange restriction	The restriction is temporary and is expected to be lifted by end-April 2009.	Approval not recommended	No waiver needed, as introduced before the approval of the arrangement.
3. Limitation on withdrawal of time deposits by individuals before the deposits' maturity.	October 13, 2008, NBU Resolution 319	Exchange restriction	This restriction is temporary and is expected to be lifted by end-October 2009, after the bank recapitalization and restructuring program has been finalized.	Approval not recommended	No waiver needed, as introduced before the approval of the arrangement.
4. The requirement that banks shall hold investors' Hryvnia proceeds from the sale of their original investment as well as revenues, profits and other funds received from investment activities in Ukraine for 5 days before converting them into foreign currency.	November 4, 2008, NBU Resolution 336	Exchange restriction	By May 2009, the NBU regulations will be amended to clarify that a longer verification period is limited to transactions with securities not traded on organized markets and that for other transactions conversion may be effected as soon as the bona fide nature of the transaction is verified.	Approval not recommended	No waiver needed, as introduced before the approval of the arrangement.

Table 11. Ukraine: Timetable for Elimination of Exchange Restrictions and Multiple Currency Practices (concluded)

Measure	Date introduced	Status Under Article VIII	Schedule for elimination/ corrective action	Recommendation for approval under Article VIII	Recommendation for waiver of nonobservance of the PCs on exchange measures
5. MCP arising from the official foreign exchange auctions.	Mid-November 2008	Multiple currency practice	The NBU could put mechanisms in place to ensure that the spreads between exchange rates within the auction and between the auction rate and other rates do not exceed 2 percent.	Approval not recommended	Waiver recommended as the measure is temporary until the foreign exchange market stabilizes
6. MCP arising from the use of the official exchange rate for certain transactions.	Mid-November 2008	Multiple currency practice	As a condition for the completion of the 1st review, the NBU will discontinue the practice of discretionary adjustments to the official exchange rate. The NBU will, on a daily basis, set the official rate at the average transaction-weighted rate of the preceding day (with intra-day adjustments if necessary to keep it within 2 percent of the market rate).	Approval not recommended	Waiver recommended based on corrective actions.

Table 12. 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	9,530	11,000	11,000	8,500	3,469	469
Percent of exports of goods and services	2	1	5	24	25	23	16	6	1
Percent of public sector external debt	6	3	22	50	50	49	41	21	3
Percent of gross reserves	3	1	14	51	53	49	36	15	2
Percent of quota	40	20	207	695	802	802	620	253	34
Existing Fund credit 1/ 2/									
Millions of SDRs	552	273	2,842	3,030	3,000	3,000	1,500	0	0
Percent of exports of goods and services	2	1	5	7	7	6	3	0	0
Percent of public sector external debt	6	3	22	16	14	13	7	0	0
Percent of gross reserves	3	1	14	16	14	13	6	0	0
Percent of quota	40	20	207	221	219	219	109	0	0
Prospective Fund credit 1/ 2/									
Millions of SDRs	0	0	0	6,500	8,000	8,000	7,000	3,469	469
Percent of exports of goods and services	0	0	0	16	18	17	14	6	1
Percent of public sector external debt	0	0	0	34	37	36	34	21	3
Percent of gross reserves	0	0	0	35	38	36	30	15	2
Percent of quota	0	0	0	474	583	583	510	253	34
Repurchases and charges due from existing and prospective drawings 2/ 3/									
Millions of SDRs	315	304	239	152	285	314	2,792	5,203	3,037
Percent of exports of goods and services	1	1	0	0	1	1	5	9	5
Percent of public sector external debt	18	19	17	7	15	15	108	72	73
Percent of gross reserves	1	1	1	1	1	1	12	22	12
Percent of quota	23	22	17	11	21	23	204	379	221
Repurchases and charges due from existing drawings 2/									
Millions of SDRs	315	304	224	66	47	47	1,537	1,514	0
Percent of exports of goods and services	1	1	0	0	0	0	3	3	0
Percent of public sector external debt	18	19	15	3	2	2	35	21	0
Percent of gross reserves	1	1	1	0	0	0	6	6	0
Percent of quota	23	22	16	5	3	3	112	110	0
Repurchases and charges due from prospective drawings 2/ 3/									
Millions of SDRs	0	0	16	86	238	267	1,255	3,688	3,037
Percent of exports of goods and services	0	0	0	0	1	1	2	7	5
Percent of public sector external debt	0	0	2	4	12	12	73	51	73
Percent of gross reserves	0	0	0	0	1	1	5	16	12
Percent of quota	0	0	1	6	17	19	92	269	221

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.

APPENDIX I

Kyiv, April 30, 2009

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

Dear Mr. Strauss-Kahn:

The attached Memorandum of Economic and Financial Policies (MEFP) describes the economic policies and objectives of the Government of Ukraine for 2009 and 2010. This program builds on the one initiated in late 2008, supported by a Stand-By Arrangement with the International Monetary Fund. The program will facilitate adjustment to the large external shocks faced by our country, and help address financial sector problems.

We believe that the policies and measures described in the attached memorandum are adequate to achieve the objectives of the program, but we stand ready to take additional policy measures, if necessary, to keep the program on track.

With this letter we also request the completion of the first program review under the Stand-By Arrangement and the disbursement of the augmented second tranche under the program. We have met the end-2008 and March 2009 base money and net international reserves targets, and completed the diagnostic studies for the first and second groups of banks, with the participation of several reputable audit firms. Revised quantitative and structural performance criteria through end-December 2009 are set out in Annexes of the attached Technical Memorandum of Understanding. However, due to some unexpected developments as well as some revisions in our policies, we request waivers of nonobservance for the following performance criteria:

- The end-March-09 quantitative PC on the general government's cash deficit (balanced fiscal position) was not observed, due to a very sizeable shortfall in government revenues driven by the rapid weakening in economic activity and a decline in tax compliance. We are thereby requesting a waiver for nonobservance of this performance criterion.

- We adopted a 2009 budget that targets a government deficit of 3 percent of GDP. However, in light of our renewed commitment to fiscal discipline and changes in the

program parameters, we request a waiver for nonobservance of the end-April 2009 structural performance criterion on the passage of a balanced budget.

- We request waivers for the nonobservance of performance criteria on the prohibition on the imposition or intensification of restrictions on the making of payments and transfers for current international transactions, and on the introduction or modification of multiple currency practices. These restrictions and practices, which were introduced to contain our balance of payments problems, are temporary and will be phased out according to a timetable (Appendix Table I.4.).

- We request a waiver for the nonobservance of a continuous performance criterion on import restrictions resulting from the imposition in February 2009 of a 13 percent import surcharge. We have recently decided to restrict this surcharge to only two commodities, and plan to remove it fully in the near future.

We would like to request a rephasing of the schedule of purchases under the arrangement, as indicated in Appendix Table I.1. The request is made for two reasons: first, disbursement of the second tranche has been substantially delayed; and second, disbursement of the third tranche was to be contingent on fiscal measures as part of an amendment to the budget. Some of these measures have already been taken. We intend to have half of the second disbursement (SDR 1 bn) be channeled directly to the government, to be used to satisfy the government's external debt obligations. We will take the necessary measures to meet our fiscal targets and continue to strengthen our efforts to develop domestic and external financing sources.

The next review will be held in June 2009. We will consult with the Fund on adoption of new measures, and in advance of revisions to the policies described in the MEFP, and provide the Fund with the information it requests for monitoring progress during program implementation. In this respect, we will maintain a close and proactive policy dialogue with the Fund, in accordance with Fund policies on such consultations.

Your sincerely,

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

UKRAINE—MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

I. BACKGROUND

1. **This memorandum lays out our revised policy framework in the context of a much more difficult economic environment.** As a major steel exporter and borrower in international markets, our private sector has been hit hard by the deeper and more protracted slowdown of the world economy, the associated decline in demand for steel products and the sharply reduced access to international capital markets. Our real GDP fell sharply in the last quarter of 2008, bringing the average growth rate for the year to 2.1 percent, and there are signs that activity has remained weak in the fist quarter of 2009. These developments require a recalibration of economic policies, but do not alter our overall economic strategy, which remains anchored in our firm commitment to restore internal and external confidence in our macroeconomic and financial stability.

2. **We are confident that the measures already taken, and those outlined in this memorandum, will facilitate a rapid adjustment of our economy to shocks.** The hryvnia has depreciated by 35 percent against the U.S. dollar since end-October and we have brought incomes policy in line with targeted inflation. Our monetary policy has been aimed at maintaining a downward trend for inflation and ensure an orderly adjustment of the currency. Our current account balance has adjusted—surplus were recorded in the first two months of 2009—and inflation has continued to decline. In addition, we are confident that the implementation of the bank recapitalization program, which is progressing in line with plans, and the recent measures to accelerate the resolution of problem banks will help restore confidence in the banking sector.

II. PROGRAM OBJECTIVES

3. **Our revised economic policies aim at minimizing the macroeconomic impact of the crisis, while setting the stage for a resumption of growth and a sustained reduction in inflation.** Our program will focus on three key areas: (i) fiscal policies which allow a large play of automatic stabilizers and accommodate the costs of bank restructuring, while keeping the deficit at a level consistent with available financing; (ii) consistent implementation of a flexible exchange rate regime to cushion the economy from external shocks; and (iii) a comprehensive restructuring of the banking sector geared toward restoring financial stability and resume credit growth.

4. **For 2009, our macroeconomic objectives have been set taking into account conservative assumptions regarding the developments in the external environment.** We expect a gradual recovery in the course of 2009, as the competitiveness gains fostered by the depreciation and somewhat higher external demand stimulate exports. However, due to the weaker than initially envisaged external conditions, real GDP could decline by 8 percent this year, compared to a contraction of 3 percent envisaged in November in the program. We will adjust our policies based on these assumptions. Given the underlying dynamism of our

economy, we believe, however, that a consistent implementation of sound policies would allow a more positive outcome, especially if the global environment becomes more supportive.

5. **We expect real GDP to start growing again in 2010, albeit at a moderate pace, and to be back to its estimated potential in the course of 2011.** This development would be driven in particular by rising investment ahead of the Euro 2012 football championship, improvements in competitiveness fostered by prudent incomes policies and more consistent implementation of a flexible exchange rate regime, resumption of global growth, and the implementation of structural reforms. The transition to an inflation targeting regime will foster price moderation. Our objective is to reduce inflation to single digits by mid-2010, and to anchor it around 5–7 percent from 2011. Our current account will be in surplus up to 2010 and afterwards deficits should remain small and readily financeable, helped by continued fiscal prudence, with reserves at safe levels.

6. **We are prepared to respond flexibly to economic developments.** Economic prospects for Ukraine depend on the depth and duration of the international deleveraging process and the accompanying global economic slowdown. If our balance of payments outcomes are better than projected, we will allow a build-up of foreign exchange reserves and adjust monetary policy to safeguard the inflation objective. In the event that developments are less favorable than expected, buffers built into our policy framework—including a flexible exchange rate and amounts available for bank recapitalization—provide a cushion, but we stand ready to take additional measures as necessary.

7. **We will explain and implement our policies in a transparent manner.** An effective and coordinated communication policy will be an integral and important part of our reform strategy, particularly in critical areas such as banking and foreign exchange markets. We will consistently explain policies to the public and market participants through regular press conferences, reports, seminars and other events. A particular emphasis will be placed on communicating in coordination and in one voice.

III. Policies For 2009–10

A. Fiscal Policy

8. **We remain fully committed to fiscal discipline.** We believe that a prudent fiscal stance is necessary to restore confidence, facilitate the adjustment of our economy to shocks, alleviate pressures on prices and the exchange rate, and avoid a large increase in our public debt. In December 2008, the Parliament adopted a budget for 2009, which included saving measures on the public sector wage bill. The budget targeted a deficit of Hrv 31.1 billion (about 3 percent of GDP). However, since the adoption of the budget, economic growth and government revenues have slowed significantly, implying a higher deficit than planned in the budget. While such a deficit would be consistent with the full operation of automatic stabilizers, we have decided, in light of the uncertainties concerning the availability of

financing, to contain it to 4 percent of GDP. To this end, in addition to a financial plan for Naftogaz that will allow us to contain the need for budget support to the company, we have taken the following measures (prior action):

- We have increased excise duties on tobacco, alcohol, and diesel to generate additional revenues in 2009;
- We have increased natural gas, electricity and coal prices, with a view to generate additional resources to the budget and reduce the need for subsidies.
- We have generated additional nontax revenues by concluding a sale of carbon emission rights;
- We have taken measures to improve the financial position of the pension fund. To contain pension expenditure and ensure timely payments during the year, we have changed indexation procedures and amended the formula for the calculation of pensions of certain categories of pensioners. We have also established a fixed pension contribution for taxpayers subject to the simplified tax system.

9. **In parallel, we are strengthening our efforts to secure additional funding from multilateral and bilateral creditors, and from domestic sources.** In particular, we are ready to take the necessary measures to secure an additional $500 million DPL loan from the World Bank for the state budget, additional financing amounting to $750 million from the World Bank "Financial sector rehabilitation loan," and additional financing from the EU, EBRD, IBRD, and EIB to modernize our natural gas infrastructure. Discussions are also going on with other potential bilateral and multilateral creditors. To develop domestic sources of budget financing, we are reviewing the conditions, market demand and features of issuing foreign currency denominated government bonds in the domestic market, while being mindful of the exchange rate risks. We have brought our treasury bill auctions more in line with market conditions, accepting market yields within predefined limits, and introduced a primary dealers system in order to facilitate the build-up of the state securities market. Finally, we are considering, if market conditions improve, to raise additional financing through privatization. With these efforts, we are confident that we can secure sufficient additional financing for 2009, in line with the amount approved in the budget.

10. **We will continue, in the coming months, to closely monitor fiscal developments and we will amend the budget as needed by end-May, in consultation with the IMF.** The tight management of expenditure has allowed us to contain the government deficit at 1.1 percent of GDP at the end of the first quarter 2009. In the coming weeks, we will take measures, in consultation with the IMF staff, to tighten tax administration. We are ready, in case of revenue shortfalls, to take offsetting fiscal saving measures to keep the government deficit below 4 percent of GDP in 2009 (excluding the costs of bank recapitalization). In case available financing turns out to be lower than expected, we will take measures to reduce the government deficit to a level that is financeable. These measures could include stronger tax

administration, elimination of VAT exemptions, and measures to improve the finances of the pension fund and Naftogaz. To further strengthen fiscal discipline and signal our commitment to avoid any increase in social payments arrears of the state and consolidated budgets, we are introducing a schedule for financing these social expenditures, including advanced payment of equalization grants to local budgets.

11. **To maintain a sustainable fiscal position in 2010 and beyond, we will, by end 2009, take structural measures to generate the necessary permanent savings. These measures include, but are not limited to, the following actions:**

- We will adopt a pension reform that will ensure the medium and long term sustainability of the pension system. The reform may include, *inter alia*, the gradual elimination of privileges regarding the payment of pension contributions by certain categories of contributors; a gradual harmonization of special pensions with the general system formula; setting the retirement age taking into account demographic developments and the increase of life expectancy in Ukraine.

- We will implement a quarterly natural gas price adjustment to reduce the deficit of Naftogaz. This will be complemented by measures to enhance tax compliance by Naftogaz and to improve gas bill payment discipline by households and communal enterprises.

- We will subject privileges on urban transport to income level and eliminate privileges on housing and communal services which overlap with better targeted programs.

- We will also reform our tax system and strengthen its administration. We will in particular reform the simplified system of taxation, including by restricting it to a limited list of activities .

12. **We would like to reassure that we have in place an effective safety net to help vulnerable groups that may be affected by the economic downturn.** We can assist them through a number of programs, including unemployment insurance; an income support scheme; housing and utilities subsidies; and lifeline utility tariffs. We will continue to review the effectiveness of these programs, in consultation with the World Bank, to ensure that they are well targeted.

B. Monetary and Exchange Rate Policy

13. **We will consistently implement a flexible exchange rate regime.** Since the adoption of the program, the hryvnia exchange rate has undergone a sizeable adjustment, which has provided a cushion for our economy to adjust to the substantial external shocks. We will publicly renew our commitment to implement a flexible exchange rate regime and a transparent intervention strategy, including via preannounced regular auctions, which facilitate price discovery in the market, and safeguard the net international reserves floors

(prior action). Given the large exchange rate adjustment so far, going forward our interventions will become increasingly exceptional and will be mainly used to dampen excessive volatility.

14. **We will take measures to improve the operation of the foreign exchange market.** We will undertake decisive steps to avoid high volume forex purchase by public enterprises and to prevent disruptions of the day-to-day operation of the foreign exchange market. We will abolish the foreign exchange transactions tax before end-September 2009. We will set the official exchange rate at the average transaction-weighted rate of the previous day, with intra-day adjustments if necessary to keep it within 2 percent of the market rate (prior action). We are planning to lift exchange restrictions and multiple currency practices according to a precise timetable (Appendix Table I.5). We will consult with the Fund staff on any further measures that affect the working of the foreign exchange market.

15. **We will keep our policy interest rates positive in real terms and maintain reserve requirements on foreign currency deposits.** We will adjust our interest rate policy to improve incentives to attract deposits back into the banking system and contain depreciation pressures on the forex market. The main goal of monetary policy will be to reduce inflation to below 16 percent in 2009. To reach this objective, we intend to keep base money in line with the program targets (quantitative performance criterion), and minimize the monetization of fiscal deficits, which could also complicate our ability to contain depreciation pressures.

16. **To enhance policy effectiveness and foster credibility, we have strengthened the independence of the NBU.** We have revoked articles 84 and 86 of the 2009 budget law and adopted resolutions that specify the conditions for NBU to extend liquidity finance to solvent banks with adequate collateral and conditionality, as well as procedures to ensure that NBU refinancing is not provided to potentially insolvent banks (both prior actions). In particular, we have strengthened the procedures for the nondiscretionary provision of liquidity support by restricting uncollateralized overnight lending and requiring high quality collateral for term refinancing through a transparent and market-oriented allocation mechanism. We will only provide financial rehabilitation loans subject to strict conditionality and strengthened supervision and base refinancing decisions on banks' needs and refrain from tying them to lending to specific sectors or industries. We have established procedures for consultation between the central bank and the government for resolving insolvent banks. The Government and the NBU will closely cooperate to restore trust in the banking system.

17. **We will strengthen the NBU's overall governance structure (including reform of the NBU council), transparency policy, and accountability framework in line with international best practices (structural benchmark).** In this context, we will amend the NBU Law to: (i) clarify the roles and responsibilities of the respective decision-making bodies; (ii) remove ambiguities and any inconsistencies with other laws; (iii) strengthen the grounds and procedures for dismissal, qualification requirements, and integrity criteria for members of decision-making bodies; (iv) provide for an independent audit oversight

mechanism that draws on relevant expertise; (v) specify the application of IFRS as the benchmark financial reporting framework; and (vi) provide for a risk-based internal audit function, including through the removal of the requirement for annual audits of all structural units.

18. **Our medium-term goal is to anchor monetary policy with an inflation targeting regime.** We are well advanced in work towards this, and to accelerate progress we intend to enhance he NBU's regularly published Monetary Review by expanding it to also cover inflation developments and prospects (in line with international practice on Inflation Reports), and to reform internal NBU decision-making processes to refocus around inflation forecasts and risks. As part of the transition toward inflation targeting, we will enhance the NBU's communications with the public regarding its policy objectives and actions.

C. Financial Sector Policy

19. **To restore financial stability and confidence in the banking sector, we have designed a comprehensive framework for the recapitalization and restructuring of the banking sector.** We have appointed a high level Expert Council comprising of the NBU and the government representatives to speed up the implementation of bank restructuring strategy, in line with the recommendations of IMF and World Bank staffs. We have submitted to the Parliament a draft law on bank resolution procedures. Our comprehensive strategy for bank resolution includes: (i) implementation of a bank recapitalization program; (ii) strengthening of the deposit insurance (deposit guarantee) system to increase public confidence in the banking system and thereby improve the mobilization of domestic savings through the system (including through the transfer of Hrv 1 bn from NBU profits); and (iii) consolidation of the banking system by means of a stronger framework for bank resolution.

20. **The diagnostic phase of the recapitalization program has been progressing as planned.** The diagnostic studies have been completed by reputable audit firms for Group 1 and Group 2, covering 34 banks accounting for 85 percent of total assets. The assessment of banks' asset quality, liquidity, off-balance sheet liabilities, profit and loss, and capital adequacy is complemented by a calculation of capital adequacy taking into account additional assumptions about future economic developments (such as GDP decline, hryvnia depreciation, fall in collateral value). Group 3 and 4 banks are being assessed based on a simplified methodology and will be completed by mid-May 2009.

21. **We will implement the next steps of the bank recapitalization program.** This part of our program is key to cushion the economy from a potentially large credit contraction. In the case of a capital deficiency, we have invited banks to present a Financial Rehabilitation Plan that include sources and timing of additional capital and liquidity injections. Based on the assessment of the plans, the NBU will decide on one of the following actions: recapitalization by existing or new shareholders; proposal to the Ministry of Finance for recapitalization using the Government securities or liquidation. We will encourage private

sector solutions within the banking sector, by shortening and simplifying the procedures for mergers or takeovers among banks.

22. **Provision of any public funds to banks will be based on stipulated and transparent technical criteria and conditions.** To this end we will take necessary legal steps to: (i) include definition and disclosure of ultimate controllers of banks by end-May 2009, and (ii) implement consolidated supervision and provide for supplementary supervision of financial conglomerates by end-May 2010 (structural benchmark).

23. **We will promptly resolve systemic problem banks**. The resolution of these banks, which have been placed under temporary administration, will include recapitalization with government participation. Current shareholdings will be revalued based on updated diagnostic study results. The depositors will be protected and gain renewed access to their funds. The new management of the banks will start workout procedures with the creditors. We will enact a joint NBU and Cabinet of Ministers resolution to set out the guiding principles for the resolution strategy, including provision of adequate liquidity support to banks that are recapitalized (prior action).

24. **We will swiftly put in place a strong bank resolution framework.** While improved, our framework does not provide a comprehensive basis for effective bank resolution, particularly when action is needed for several banks simultaneously, owing to a heavy reliance on appointing temporary administrators. To achieve least-cost bank resolution, the NBU have created a dedicated resolution unit that will be authorized to resolve problem banks and coordinate, supervise and effectively manage the activities of the temporary administrators, liquidators, as well as manage distressed assets in order to ensure that the banks meet their liabilities. We have established a Recapitalization Unit within the Ministry of Finance to handle the capital participation of the state in undercapitalized banks. However, we acknowledge that for these institutions to work effectively, they need to be supported by a strong legislative and judicial framework. Therefore, we will swiftly adopt the necessary legal amendments to enable dilution of shareholder capital, transfer of assets and liabilities without prior approval of creditors, simplifying and accelerating the process for bank mergers and acquisitions, and enabling the government to provide funds for banks under resolution by the NBU.

25. **The Government and the NBU will continue to promote a level playing field for all banks, including by channeling public sector services via all banks in a nondiscriminative manner.**

26. **To enhance banking sector transparency, we have prepared a framework for publication, on a quarterly basis, of detailed bank-by-bank financial information in line with international best practices.** From September 2009, we will publish detailed balance sheets and income statements, information on bank capitalization, ownership and credit quality, with separate information for domestic and foreign currency assets and liabilities

(including the maturities and time to repricing) and a sectoral breakdown (structural benchmark).

D. Private Sector Support Policies

27. **We will accelerate the adoption of measures to facilitate voluntary restructuring of unsustainable corporate and household debt.** In anticipation of an increase in corporate insolvencies, we will submit to parliament amendments to 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 an overall reduction of the time needed for bankruptcy proceedings. This will notably involve limiting procedural delays by reducing the scope for excessive appeals and introducing provisions on expedited court approval of debt restructuring plans negotiated between debtors and creditors (structural benchmark).

28. **While preserving due process, we seek to create a credible mechanism to induce debtors to restructure without bringing the case to the stage of court litigation.** We will prepare these amendments in consultation with Fund staff, and would request technical assistance on this issue. With respect to household mortgage debt, much of which is denominated in foreign currency, we will continue to introduce incentives for voluntary restructuring, in close consultations with the banking community. The NBU has introduced reporting requirements to monitor progress with voluntary restructurings. Based on that data, we will reassess the situation jointly with Fund staff at the time of the second review and, if necessary, consider additional measures to resolve unsustainable debt. We will avoid introducing measures that may have a further negative impact on the financial condition of banks such as an unconditional ban on foreclosures or an obligatory loan restructuring scheme.

E. Safeguards Assessment

29. **The updated safeguards assessment of the NBU has been completed.** The assessment found that aspects of the NBU's safeguards framework have been strengthened since the 2004 assessment, but it also noted that the ongoing financial crisis has significantly increased the central bank's financial and operational risks. We concur with the assessment's main findings and recommendations, and commit to implementing the latter within the proposed deadlines. In particular, an independent review of NBU's refinancing and currency interventions in 2008 will be conducted in the coming weeks by a specialist audit team from an international audit firm under terms of reference to be agreed with the IMF staff. The objectives of this review will be to verify compliance with all applicable resolutions and control procedures. The final report will be completed by mid-June 2009 and shared with Fund staff. The report will be submitted to the Auditing Chamber of Ukraine and its main conclusions will also be published on the NBU's website. In addition, we concur with the need for improved governance and independent oversight and commit to addressing this and

the other safeguards–related weaknesses in the legal framework during the next revision of the NBU Law.

F. Program Monitoring

30. **The program will continue to be monitored through regular reviews, prior actions, quantitative performance criteria and indicative targets, and structural benchmarks.** The phasing of purchases under the arrangement and the review schedule are set out in Table 1 of this memorandum; the quantitative targets for end-June 2009, end-September 2009 and end-December 2009, and continuous performance criteria, are set out in Table 2; and the prior actions, and structural benchmarks are set out in Tables 3. Table 4 sets out the timetable for the phasing out of exchange restrictions and multiple currency practices. The understandings between the Ukrainian authorities and IMF staff regarding the quantitative performance criteria and the structural measures described in this memorandum are further specified in the TMU attached to this memorandum.

31. **We will continue to provide data on a regular and timely basis for the purpose of program monitoring.** We will designate one person in the NBU who will be responsible for all data provision to the IMF. In addition, the NBU's Internal Audit Department will—within six weeks following each test date—issue an assurance report that confirms that the monetary data for the test dates are in accordance with program definitions and have been verified and reconciled to accounting records, and that there have been no changes to the chart of accounts or valuation method that would impact the data reporting.

32. **The next review will be held in June 2009, and the following ones quarterly thereafter for the duration of the arrangement**.

Appendix Table I.1. Ukraine: Access and Phasing Under the Stand-By Arrangement[3]

Date Available	In millions of SDRs	In 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	

[3] Reflects the rephasing of the second and third purchases requested in the LOI.

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

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

	Stock (actual)		2009		
	Dec 2008	Mar 2009	May Prog.	Sept Prog.	Dec Prog.
I. Performance criteria					
Ceiling on the cash deficit of the general government (- implies a surplus) 2/ 3/ 4/ 5/	30,026	11,040	22,500	25,000	40,000
Floor on net international reserves of the NBU (in millions of U.S. dollars)	27,811	22,238	19,700	16,600	14,900
Ceiling on base money	186,671	174,764	193,000	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	n.a.	100	100	100

Sources: Ukrainian authorities; and Fund 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.

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

Prior Actions for the First Review	***Status***
A1. Revoke Articles 84 and 86 from the 2009 Budget Law.	
A2. Enact a joint NBU and Cabinet of Ministers resolution to set out the guiding principles for the resolution strategy, including provision of adequate liquidity support to banks that are recapitalized.	
A3. Adopt resolutions that specify the conditions for NBU to extend liquidity finance to solvent banks with adequate collateral and conditionality, as well as procedures to ensure that NBU refinancing is not provided to potentially insolvent banks.	
A4. Publication of a statement by the NBU renewing the commitment to implement a flexible exchange rate regime and a transparent intervention strategy, including via pre-announced regular auctions.	
A5. Adopt and implement a resolution specifying that the official exchange rate will be set, on a daily basis, at the average transaction-weighted rate of the previous day (with intra-day adjustments if necessary to keep it within 2 percent of the market rate).	
A6. Announce a tender for a Special Audit of NBU refinancing and foreign exchange operations in 2008, to be executed by a qualified international audit firm, on the basis of a terms of reference agreed with IMF staff .	
A7. Adopt measures reducing the general government deficit by at least 1 percent of GDP in 2009.	
Structural Benchmarks	***Date***
B1. Ensure de jure and de facto independence of the NBU. 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-May 2009
B2. Enact necessary amendments to legislation to:	
(i) include definition and disclosure of ultimate controllers of banks,	End-May 2009
(ii) enable revaluation of shareholder capital, transfer of assets and liabilities without prior approval of creditors, simplifying and accelerating the process for bank mergers and acquisitions, and enabling the government to provide funds for banks under resolution by the NBU, and	End-May 2009
(iii) implement consolidated supervision and provide for supplementary supervision of financial conglomerates.	End-May 2010
B3. 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
B4. Start publishing 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
B5. Conclude the independent review, by a specialized audit team from an international accounting firm, of NBU's refinancing and currency interventions in 2008, and share a report with the IMF staff.	Mid-June 2009

Appendix Table I.4. Ukraine: Timetable for Elimination of Exchange Restrictions and Multiple Currency Practices

Measure	Date introduced	Schedule for elimination/ corrective action
Prohibition on purchase of foreign exchange for settlement on imports that do not enter Ukraine and are designated for further resale to non-residents.	December 4, 2008, NBU Resolution 413	The restriction is temporary and is expected to be lifted by end-April 2009.
Limit in an amount equivalent of UAH 75.000 per month on purchase of foreign exchange on the interbank market and on transfers for non-trade transactions by resident and non-resident individuals.	October 29, 2008, NBU Resolution 340	The restriction is temporary and is expected to be lifted by end-April 2009.
Limitation on withdrawal of time deposits by individuals before the deposits' maturity.	October 13, 2008, NBU Resolution 319	This restriction is temporary and is expected to be lifted by end-October 2009, after the bank recapitalization and restructuring program has been finalized.
The requirement that banks shall hold investors' Hryvnia proceeds from the sale of their original investment as well as revenues, profits and other funds received from investment activities in Ukraine for 5 days before converting them into foreign currency.	November 4, 2008, NBU Resolution 336	By May 2009, the NBU regulations will be amended to clarify that a longer verification period is limited to transactions with securities not traded on organized markets and that for other transactions conversion may be effected as soon as the bona fide nature of the transaction is verified.
MCP arising from the official foreign exchange auction.	November 2008	The NBU could put mechanisms in place to ensure that the spreads between exchange rates within the auction and between the auction rate and other rates do not exceed 2 percent.
MCP arising from the use of the official exchange rate for certain transactions.	November 2008	As a condition for the completion of the 1st review, the NBU will discontinue the practice of discretionary adjustments to the official exchange rate. The NBU will, on a daily basis, set the official rate at the average transaction-weighted rate of the preceding day (with intra-day adjustments if necessary to keep it within 2 percent of the market rate).

UKRAINE—TECHNICAL MEMORANDUM OF UNDERSTANDING

April 30, 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 the National Bank of Ukraine

3. Net international reserves (NIR) of the National Bank of Ukraine (NBU) 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 of the NBU (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[4] 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[5]	NBU Balance Sheet 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[6]
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

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

[5] 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.

[6] 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 accounts.

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 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,[7] 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

[7] 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.

- 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 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.

II. OFFICIAL EXCHANGE RATE

Determination of the official exchange rate

12. 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

13. 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.

14. 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.

15. 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.

16. 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.

17. 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.

18. 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.

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

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

21. 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.

22. 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.

23. 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.

24. 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.

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

26. 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.

27. 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.

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

B. Ministry of Finance

29. 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.

30. 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.

31. 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.

32. 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.

33. 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.

34. 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.

35. 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.

36. 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).

37. 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.

38. 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.

39. 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.

40. 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.

41. 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.

42. 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.

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

44. 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

45. 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										

46. 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.

47. 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.

48. 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