INTERNATIONAL MONETARY FUND

IMF Country Report No. 22/323

UKRAINE

October 2022

REQUEST FOR PURCHASE UNDER THE RAPID FINANCING INSTRUMENT—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR UKRAINE

In the context of the Request for Stand-by Arrangement, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on October 7, 2022, following discussions on October 1, 2022, with the officials of Ukraine on economic developments and policies underpinning the IMF arrangement under the Rapid Financing Instrument. Based on information available at the time of these discussions, the staff report was completed on October 3, 2022.
- A **Statement by the Executive Director** for Ukraine.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

IMF Executive Board Approves US$1.3 Billion in Emergency Financing Support to Ukraine

FOR IMMEDIATE RELEASE

- *The IMF Executive Board approved the disbursement of US$1.3 billion to Ukraine under the new food shock window of the Rapid Financing Instrument.*
- *More than seven months after the start of Russia's invasion of Ukraine, the humanitarian and economic toll remains massive, resulting in large and urgent fiscal and external financing needs.*
- *The Ukrainian authorities deserve considerable credit for having maintained an important degree of macro-financial stability in these extremely challenging circumstances.*

Washington, DC – **October 7, 2022.** The Executive Board of the International Monetary Fund (IMF) today approved a disbursement of US$1.3 billion (SDR 1,005.9 million) under the food shock window of the Rapid Financing Instrument (RFI) to help meet Ukraine's urgent balance of payments needs.

The scale and intensity of Russia's war against Ukraine that started more than seven months ago have caused tremendous human suffering and economic pain. Amid massive population displacement and destruction of housing and key infrastructure, real GDP is projected to contract by 35 percent in 2022 relative to 2021 and financing needs remain very large. This disbursement under the RFI (equivalent to 50 percent of Ukraine's quota in the IMF) will help meet urgent balance of payment needs, including due to a large cereal export shortfall, while playing a catalytic role for further financial support from Ukraine's creditors and donors.

The authorities deserve considerable credit for having maintained an important degree of macro-financial stability in these extremely challenging circumstances and have requested program monitoring with board involvement to strengthen their policy commitment and further catalyze donor support.

The Executive Board reiterated its strong support for the Ukrainian people.

Following the Executive Board discussion, Ms. Kristalina Georgieva, Managing Director and Chair, made the following statement:

"Russia's invasion of Ukraine that started over seven months ago has caused large loss of life, massive population displacement, and significant destruction of infrastructure and housing. The impact on economic activity has been enormous: real GDP has severely contracted, inflation has risen sharply, trade has been significantly disrupted, and the fiscal deficit has increased to unprecedented levels.

"The Ukrainian authorities deserve considerable credit for having maintained an important degree of macro-financial stability in these extremely challenging circumstances. As the economy adapts to the now prolonged war, key macroeconomic policies have been geared toward safeguarding priority expenditures, easing pressure on the hryvnia and international reserves, and preserving financial stability.

"Against this backdrop, and in light of the persistent urgent balance of payments needs, including due to a large shortfall in cereal exports, the IMF has approved new emergency financing for Ukraine totaling SDR 1,005.9 billion (about US$1.3 billion) under the new Food Shock Window.

"Ukraine faces risks and uncertainties related to the hazardous security situation, policy implementation capacity, and external developments. Unique to the extreme circumstances now prevailing in Ukraine, very high uncertainty makes it difficult, at present, to assess with sufficient precision what would be required to ensure sustainability of Ukraine's debt, but the balance of probabilities suggests that there are higher risks of debt being unsustainable.

"In conjunction with Ukraine's continued commitment to economic, fiscal and governance reforms as well as strong engagement of all other stakeholders, including International Financial Institutions and the private sector, the bulk of Ukraine's official bilateral creditors and donors— through the relevant Executive Directors at the Fund—have signaled that they intend to continue financially supporting Ukraine to help achieve a balanced growth path and medium-term external viability.

"In order to allay the risks to the Fund from lending to Ukraine under these circumstances, these bilateral creditors and donors have reaffirmed their recognition of the Fund's preferred creditor status in respect of the amounts outstanding to Ukraine, including the requested drawing by Ukraine under the new RFI Food Shock Window. They undertake—given Ukraine's continuing cooperation with the Fund—to provide financial support on appropriate terms to secure Ukraine's ability to service to the Fund its existing obligations that have already been approved by the Executive Board and the amounts provided under the new Food Shock Window, in accordance with the Fund's preferred creditor status. They have also confirmed that during this initial period of support by the Fund a deferral by the Group of Creditors of Ukraine will be in place as announced on July 20, 2022, with respect to those obligations of Ukraine that are falling due to them.

The Fund will remain closely engaged with the Ukrainian authorities, with whom staff discussions will start soon on Program Monitoring with Board involvement (PMB). The PMB will aim to provide a strong anchor for macroeconomic policies, further catalyze donor support, and help to pave the way towards the upper credit tranche arrangement."

INTERNATIONAL MONETARY FUND

UKRAINE

REQUEST FOR PURCHASE UNDER THE RAPID FINANCING INSTRUMENT

October 3, 2022

EXECUTIVE SUMMARY

Context. The Russian invasion of Ukraine that started over seven months ago has caused large loss of life, large population displacement, and significant infrastructure damage. The impact on economic activity has been enormous: real GDP has severely contracted, inflation has risen sharply, trade has been significantly disrupted, and the fiscal deficit has ballooned to unprecedented levels. In the immediate aftermath of the invasion, the authorities quickly adapted monetary and exchange rate policies to preserve financial and exchange rate stability. More recently, and to help reverse significant international reserves loss, the exchange rate was devalued, helping to stabilize FX reserves and maintain overall macroeconomic and financial stability. Fiscal policy has been geared to priority spending on defense, social benefits, humanitarian needs, and where possible some fixing of critical infrastructure. Uncertainty around the size of financing needs remains extremely elevated and highly dependent on the length of the war and its intensity, and economic risks loom large, including those related to potential additional damage to critical infrastructure or new disruptions to the agricultural and energy sectors.

Request for Fund Support. Ukraine's purchase under the Rapid Financing Instrument (RFI) in the early days of the war on March 9, 2022, was instrumental in helping the authorities meet emergency financing needs and in catalyzing donor support. In light of the persistent urgent balance of payments needs and a large shortfall in cereal exports, the Ukrainian authorities are requesting financial assistance under the new food shock window of the RFI. Staff supports this request, with access proposed at SDR 1,005.9 million (about US$1.3 billion), equivalent to the maximum available amount of 50 percent of quota. Unique to the extreme circumstances now prevailing in Ukraine, very high uncertainty makes it difficult, at present, to assess with sufficient precision what would be required to ensure sustainability of Ukraine's debt. Commitments from Ukraine's official bilateral creditors and donors are assessed by staff to provide sufficient safeguard assurances for a purchase under the RFI as a combination of appropriate macroeconomic policies and exceptional financing from Ukraine's creditors and donors would be able to restore medium-term viability under a range of scenarios.

Macroeconomic Policies. As the economy adapts to the now prolonged war, macroeconomic policies have forcefully adjusted to reduce non-priority expenditures, ease pressure on the hryvnia and FX reserves, and preserve financial stability. The authorities have also adopted wide-ranging emergency measures since Russia's invasion including administrative FX and capital controls, a suspension of regulatory and supervisory enforcement actions, postponement of audits of banks' financial statements, and forbearance with respect to restructured loans. However, significant challenges lie

ahead. The tax base has been eroded, and domestic bank financing has not been forthcoming, resulting in a partial monetary financing of the fiscal deficit. To further strengthen collaboration with the Fund and maintain large donor support, the authorities are also requesting a Program Monitoring with Board Involvement (PMB). This instrument will be expected to provide a solid framework to anchor macroeconomic and financial stability, support appropriate macroeconomic policies, and ensure transparency and accountability in procurement. The aim is to pave the way for an eventual full-fledged Fund-supported program when conditions allow.

Approved By
Julie Kozack (EUR) and Martin Čihák (SPR)

Discussions were held by videoconference on October 1, 2022 with Finance Minister Marchenko, Governor Shevchenko, and other senior officials. V. Rashkovan (OED) joined the discussions. The staff team comprised G. Gray (head), A. Khachatryan, S. Nadeem, and J.G. Poulain (all EUR), T. Orav (SPR), D. Monaghan (MCM), V. Stepanyan (resident representative), and I. Shpak and M. Sydorovych (local economists). L. Herrera Prada and N. Gonzales (all EUR) assisted in the preparation of the report.

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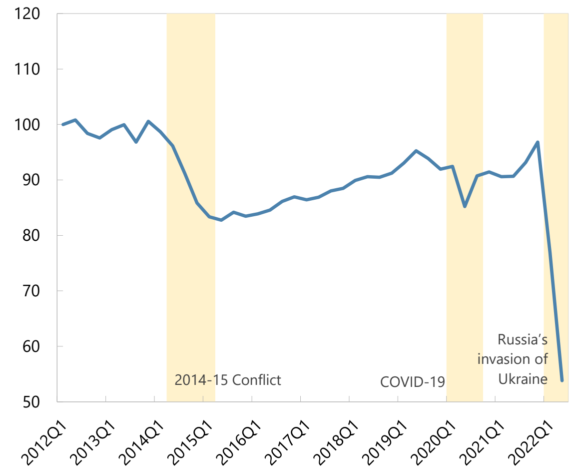
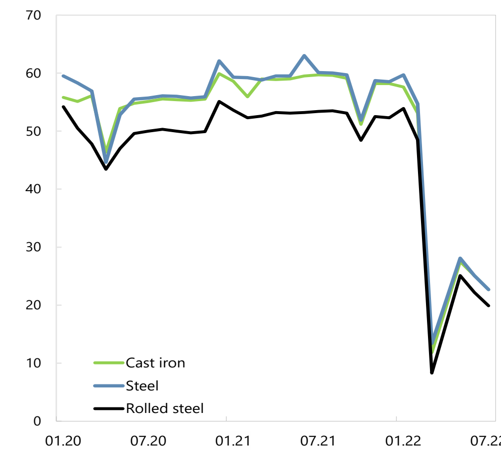
RECENT DEVELOPMENT AND OUTLOOK

1. **Seven months after the start of the Russian invasion, there is no clear end in sight for the war.** The significant duration, scale, and intensity of Russia's invasion of Ukraine presents an ongoing shock of exceptional size. Active combat remains intense but has become more localized, mainly taking place in four regions of Ukraine (Donetsk, Luhansk, Kherson and Zaporizhzhia) whose annexation was recently announced by Russia and condemned by the UN Secretary General as a violation of the UN charter and international law. The war is now estimated to impact areas that account for about 15 percent of pre-war GDP as compared to about 40 percent in March. Economic activity, policies, as well as fiscal and external financing gaps continue to be driven by war-related developments, and considerable uncertainty remains.

Real GDP
(Index, 2012Q1 = 100)



Average Daily Production of Steel, Cast Iron and Rolled Steel (In Thousand Tons)



Source: State Statistics Service of Ukraine, Ukrmetallurgprom

2. **Ukraine's population and physical capital have already been profoundly impacted by the war.**

- There has been widespread loss of life,[1] and over 7 million Ukrainians—about a fifth of the population—have left the country with a similar number internally displaced, exerting pressure on the social protection system. The labor market is facing dislocations, with changes to the size and composition of the labor force due to the large outward migration (mainly of highly skilled women), the conscription of men aged 18–60, and internal displacement. The number of registered unemployed per job vacancy has jumped from 6 to 12 since the beginning of the war, while survey data points to an unemployment rate of up

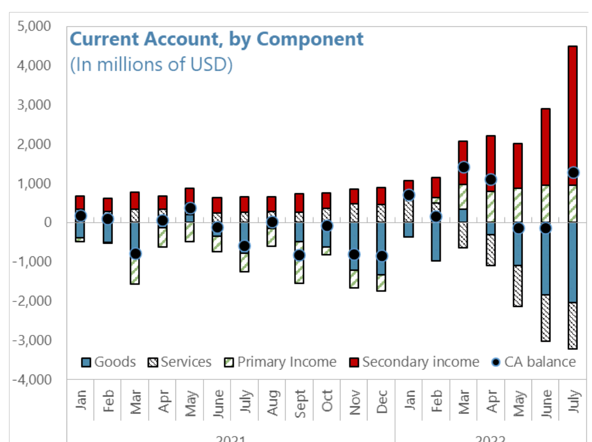
[1] According to The Office of the UN High Commissioner for Human Rights (OHCHR), as of September 19, 2022, 5,916 civilians had been killed and 8,616 injured since February 24, 2022.

to 40 percent. Real wages (excluding defense) have declined significantly, and the World Bank estimates that poverty rates could increase tenfold to 21 percent.

- Infrastructure damage is colossal and increasing. In its recent Rapid Damage and Needs Assessment, the World Bank estimates that the war had already caused physical damage, of US$97 billion (over half of pre-war GDP) as of June 2022, mainly to residential buildings, roads and bridges. Reconstruction costs are currently estimated at US$349 billion. Operational disruptions and loss of capacity have been particularly large in the metals sector (5 percent of pre-war GDP) as well as agriculture (12 percent of pre-war GDP), due to their proximity to active combat zones. War-related logistical challenges continue to strain the economy, including relating to the operation of ports, transportation networks, and energy infrastructure.

3. **Against this background, the impact on economic activity has been enormous.** Flash estimates suggest GDP growth declined by 37.2 percent y/y in 2022Q2, following a 15.1 percent y/y fall in 2022Q1. Active combat has shifted to the Eastern and Southern regions, while activity in noncombat zones has started to stabilize as the economy adjusts to the war setting, notably in the Kyiv region, which accounted for a third of pre-war GDP. Nevertheless, private consumption and investment remain weak, due to the erosion of purchasing power, binding financing constraints, and large outward migration, as government spending becomes a key driver of the economy. GDP is now expected to contract by about 35 percent for the year (the same forecast as in the April 2022 WEO, and worse than the 10 percent contraction estimated at the March RFI request), reflecting, on the one hand, the longer than expected duration of the war, and on the other, the recovery in activity. At the same time, persisting war-related supply disruptions as well as pressure from high global energy prices and hryvnia devaluation pushed headline inflation to 23.8 percent y/y in August 2022 (a steep increase from 10 percent y/y in January 2022), while core inflation reached 19.1 percent y/y. Headline inflation is projected to reach 30 percent by the end of 2022.

4. **The current account moved into surplus as significant current transfers (grants) more than offset the large and widening trade deficit.** Trade declined sharply as the war initially disrupted activities, but as conflict became more localized, imports recovered quicker than exports. The loss of critical seaports (such as Mariupol) and the blockade of the Black Sea coast precluded bulk shipping of agricultural and metallurgical goods through July. Agriculture exports picked up somewhat in August supported by the grain corridor allowing exports via seaports but remain about 30 percent below 2021 levels. Meanwhile, imports have fallen by less than exports, by 20 percent y/y, reflecting continued demand for essentials such as fuel

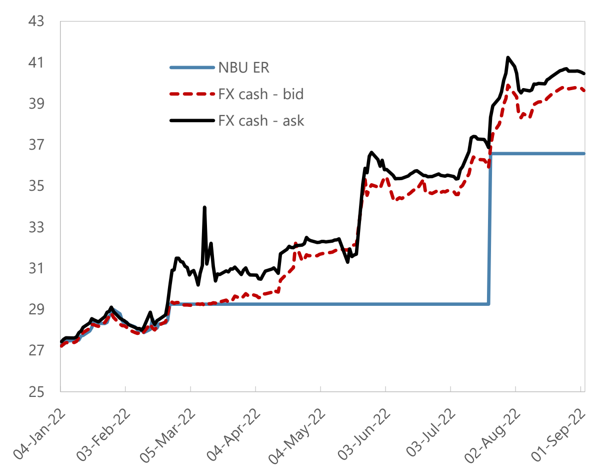


Source: National Bank of Ukraine.

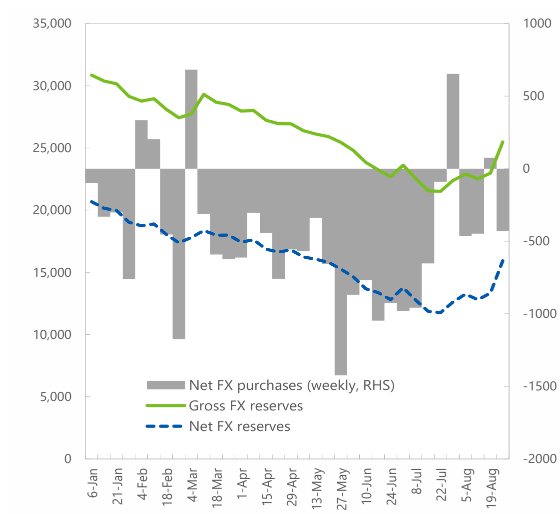
and equipment, and a surge in imports earlier in the year due to (now-rescinded) preferential import taxes and an overvalued exchange rate. The services balance has also shifted to a deficit due to bank account withdrawals from migrants abroad. However, the income balances have been supported by sizable grants and humanitarian support, resulting in an overall current account surplus of about US$1.3 billion as of end-July.

5. Pressure on the hryvnia and FX reserves rose through mid-year but has eased somewhat since the devaluation of the exchange rate peg and disbursement of sizable external inflows. The war led to imbalances in the FX market, with constraints on FX supply due mainly to logistical challenges to exports, and increased FX demand, due to continuing import needs, outflows from migrants, and depreciation expectations. This put pressure on the hryvnia, with the cash rate (on the shadow foreign exchange market) deviating from the official pegged rate by around 25 percent by end-June. At the same time, the NBU had to intervene in the FX market in increasing amounts, with monthly sales reaching US$4 billion by June. In mid-July, the NBU devalued the exchange rate peg by 25 percent and tightened limits on withdrawals by Ukrainians abroad, while import duties were reintroduced. Since then, pressures in the FX market have abated, with FX sales slowing and the deviation of the new peg with the cash rate narrower. Notwithstanding the NBU's FX sales, gross international reserves amounted to US$24.3 billion as of September 23, as compared to US$30.9 billion at end-2021, supported by large external financing disbursements.

Exchange Rate
(Hryvnia per U.S. dollars)



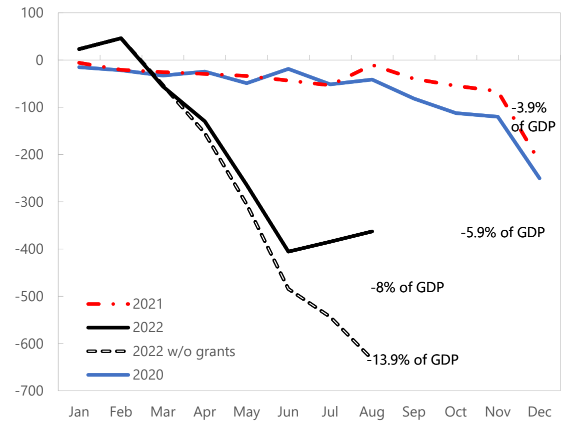
FX Reserves and Net FX Purchases from the NBU
(Millions of U.S. dollars)



Source: NBU

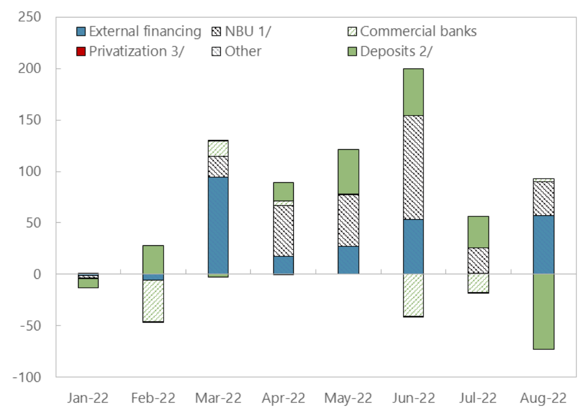
6. The war is causing an unprecedented widening of the fiscal deficit amid acute financing constraints. Tax revenues have been constrained due to the decline in economic activity. Meanwhile, despite the compression of nonessential expenditures, spending continued to increase, largely driven by the defense effort. As a result, the fiscal deficit excluding external grants is estimated to have reached 13.9 percent of 2022 GDP as of end August 2022 (measured from below the line). Thanks to the large boost to non-tax revenues provided by external grants, the overall end-August fiscal deficit was lower, at about 8 percent of 2022 GDP, and mostly financed by disbursement of external loans (about US$9 billion or 6 percent of GDP as of end-August) and domestic net bond financing (about UAH 194 billion, or 4.2 percent of GDP).[2,3] Despite ample liquidity, domestic commercial bank financing of the government has been limited and turned net negative cumulatively since the beginning of the war. This reflects in part the limited transmission of the key policy rate (KPR), now at 25 percent, to local currency government debt securities, which are offered on the primary market at around 14–16 percent, a negative return in real terms.

Cumulative Fiscal Balance
(In UAH billions)



Source: MoF, IMF staff estimates.

Monthly Government Financing
(In UAH billions)



1/ Includes securities and direct credit. 2/TSA and commercial banks
3/ Includes privatization receipts, confiscation, Ukravtodor and nonbank securities.

7. Despite the increase in monetary financing, base money has remained contained. NBU purchases of government war bonds on the primary market have been largely sterilized by FX sales and banks' purchases of NBU overnight certificates of deposits, resulting in nominal base money growth of 15.2 percent as of end-August (compared to 13.1 percent y/y at end-January). Currency in circulation has also remained relatively contained, growing at 17.6 percent y/y as of end-August, reflecting the stability of bank deposits and the use of noncash payments. Credit to the private sector expanded by about 7 percent y/y as of August, driven mainly by government-supported lending to corporates.

8. The financial system has demonstrated some resilience, although its health is difficult to assess with precision. Asset quality is deteriorating, but large-scale forbearance with a delayed recognition of NPLs and the suspension of NBU enforcement actions and audits of financial statements make a comprehensive assessment of the impact of the war difficult and uncertain. As of mid-September, 87 percent of bank branches remain operational, online banking services are fully available to all clients with internet connectivity and the non-cash payment system is functioning normally.[4] The banking system's hryvnia retail deposits grew by

[2] Net domestic financing covers NBU, banks, and non-banks. As of end August 2022 the stock of NBU war bonds was at 6.2 percent of 2022 GDP and as of September 20, 2022, at 6.9 percent of 2022 GDP.

[3] Large financing disbursements also resulted in an accumulation of deposits in the banking sector (including NBU) of about 2.3 percent of GDP.

[4] Bank branches in the Donetsk, Kherson and Luhansk regions remain mostly closed.

24.5 percent since the onset of the war to end-August, buoyed by social transfers and salaries being credited to personal bank accounts, while foreign currency deposits declined by 6.6 percent in US dollar terms. Corporate deposits remained stable during the same period with hryvnia deposits declining by 1.3 percent and foreign currency deposits rising by 3.1 percent. Banks remain highly liquid with the Liquidity Coverage Ratio (LCR) and High-Quality Liquid Assets (HQLA) remaining relatively high for the majority of banks. The licenses of four small banks (2.8 percent of system assets) have been revoked under Martial Law. Access to the emergency unsecured financing facility introduced by the NBU following the outbreak of the war has been tightened, as bank liquidity recovered, and many banks have repaid refinancing loans ahead of schedule.[5] Nevertheless, careful monitoring and a gradual unwinding of this form of liquidity support will be required as conditions normalize.

9. However, rising credit risks and falling fee and commission income will harm the profitability and solvency of the financial system. The official NPL ratio as of end-May was 16.5 percent.[6] Banks have also granted payment holidays on retail and corporate loans for the duration of the Martial Law and cancelled fees and commissions on cashless payments as well as cash withdrawals. Prospects for banking system profitability are therefore significantly weakened. Although outstanding credit to GDP is relatively low at 14 percent, banks' loan portfolios are also vulnerable to several adverse developments including rising interest rates; a declining exchange rate (a third of bank lending is denominated in foreign currency); and damage to real collateral used for credit enhancement. The banking sector recorded US$1.1 billion (UAH 33 billion) of loan loss provisions for credit losses between March and May, a four-fold increase over the previous year. Banks' retail loan portfolios shrank by around 10 percent and mortgage lending came to a halt, but corporate lending has grown slightly due to various government support schemes.

10. With a more protracted war, the outlook for 2023 remains subdued and highly uncertain. In staff's baseline projection, growth is expected to rise to 3.5 percent in 2023, reflecting continued government spending and a modest pickup in private activity assuming the economy continues to adjust to the dynamics of the war after this year's collapse. Inflation is expected to decline but remain high, around 22.5 percent y/y by year end, reflecting residual supply bottlenecks and the lagged effect of exchange rate depreciation. Exports are projected to pick up only gradually given war-related damage to capacity and lingering logistical constraints, while imports are expected to remain robust due to the continued need to import necessities to support the war effort and rehabilitation.[7] Public debt is projected to reach 87.8 percent of GDP by end-2022 and stabilize around that level under the baseline.

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[5] Use of the unsecured facility fell from UAH 15.6 billion on March 16 to UAH 0.08 billion as of September 16.

[6] The NPL ratio rises to 32.2 percent when PrivatBank's legacy related-party NPLs are included.

[7] Estimates do not include a forecast for imports required under an extensive reconstruction effort, nor incorporate demand for defense equipment, which are assumed to be delivered in kind and do not constitute a drain on foreign exchange reserves.

11. Risks to the outlook remain exceptionally high and dependent on the length and intensity of the war. A prolonged war would further increase the loss of life and the deterioration of physical and human capital, while driving a sharp decline in living standards, exacerbating poverty, and lead to severe economic scarring. An intensification of the war in 2023 would dampen the growth outlook, while the potential increase in defense spending, and additional strains on energy finances for the heating season, particularly without associated external financing, would also pose a risk to the fiscal position. Shortfalls in external financing for 2023 would increase the risk of excessive monetization of the deficit, which could threaten price and exchange rate stability. The war could continue to strain domestic and global energy and food prices, raising inflation and putting pressure on the fiscal and external positions. Renewed loss of port access or an insufficient capacity of alternate logistics routes could deter planting decisions for future agriculture seasons, affecting exports and global food security. Electricity supply disruptions or further pressure on gas stocks could take an additional toll on economic activity. Contingent liabilities from large state-owned enterprises in the energy sector as well as from the banking sector—where asset quality is weakening by a large but yet uncertain size—could add to already large financing needs.

ECONOMIC POLICIES

12. The National Bank of Ukraine has quickly adapted monetary and exchange rate policies as economic conditions evolved. It has had to balance considerations on price and exchange rate stability, financial stability, as well as ensure the adequacy of FX reserves.

- The immediate policies undertaken following the outbreak of the war—including fixing the exchange rate (UAH 29.2549/U.S. dollar), capital flow management measures, and restrictions on bank account withdrawals—helped to preserve financial stability. The NBU also suspended changes to the key policy rate (KPR), by keeping it at 10 percent, citing impairment of the monetary transmission mechanism through the interest rate channel.

- In June, in order to raise the attractiveness of hryvnia assets and ease pressures on FX reserves, as well as address increasing inflation and exchange rate expectations, the NBU increased the KPR by 1,500 bps to 25 percent.

- In July, in response to continuing pressure on the hryvnia and FX reserves, the NBU also devalued the exchange rate peg by 25 percent to UAH 36.5686/U.S. dollar. It also tightened capital flow management measures, including on withdrawals from abroad, and undertook measures to ease imbalances in the FX market, including a tax on FX purchases. This has been supported by the restoration of import taxes.

- The NBU has maintained the KPR at 25 percent in subsequent MPCs, signaling its intention to keep the KPR at this level until 2024Q2, as well as the willingness to hike the policy rate further should risks to inflation and the exchange rate materialize.

13. Wide-ranging emergency measures have supported financial stability. The NBU and commercial banks quickly implemented business continuity plans and some of the largest banks have since fully migrated their IT systems to the cloud. The NBU introduced administrative FX controls and capital controls to preserve FX liquidity and channel it towards priority imports. Limited interbank FX trading has been allowed to facilitate the purchase of critical imports. FX deposit cash withdrawals were capped at UAH 30,000 (US$815) per day and hryvnia daily cash withdrawals were limited to UAH100,000 (US$2,700). Banks can access unsecured funding with a maturity of up to one year for an amount up to 30 percent of their late-January retail deposits. NBU enforcement actions have been suspended for breaches of prudential requirements regarding capital, liquidity, credit risk, net open positions in FX and for delays in prudential reporting. Audits of banks' financial statements and regular bank stress testing have been postponed. Loans restructured during the martial law period are exempt from reclassification for credit risk, some regulatory risk weights have been decreased, and banks have been prohibited from related party lending, capital distributions (dividend payments and share buy-backs), and bonus payments.

14. The fiscal deficit is projected to reach close to 20 percent of GDP at end-2022, subject to a high degree of uncertainty. Without the revenue boost provided by large external grants (US$ 10.5 billion, about 8.4 percent of GDP), the deficit would have been much larger, at about 28 percent of GDP. Amid a deep economic contraction, tax revenues are projected to drop by about 3.0 percent of GDP, primarily driven by a decline in taxes on goods and services, CIT, and property taxes.[8] The authorities have started to phase out some temporary tax measures introduced under the Martial law and are working towards restoring revenue administration operations. At the same time, despite cuts in non-priority spending, current expenditures are estimated to increase by about 24 percentage points of GDP. This is primarily driven by defense spending—which is projected to reach a record 27 percent of GDP—as well as urgent social spending and other critical needs, including to restore basic livelihoods in war-affected areas.

15. The fiscal financing gap for 2022 has narrowed thanks to sizeable support from international partners and coordinated suspension of debt service due by Ukraine. The deferral of debt service obtained from private bondholders, the G7 and Paris Club members is estimated to save about US$6 billion in debt service through end-2023. Assuming the authorities continue to tap limited purchases of war-bonds by the NBU (allowed under the Martial Law) and timely disbursement of the US$31.5 billion of committed external loans and grants (including the proposed purchase under the RFI and about US$ 2.2 billion in loans and grants already disbursed through the Administered Account established by the Fund in April), the residual financing gap would be about US$4 billion (2.8 percent of GDP). This gap is primarily driven by needs to support the energy sector and additional defense spending.[9] (see Text Table 1).

[8] Despite the severity of the GDP contraction in 2022, a few factors have supported tax revenues in 2022: (i) good performance of PIT and social security contributions (SSC) in light of the massive increase in defense sector wages; (ii) inflation and (iii) initially, a patriotic effort from employers to pay full SSC even if employees were working half time.

[9] Needs for further gas imports this year may require additional financing that has yet to be identified. Subject to considerable uncertainty related to consumption patterns, staff estimate that under the baseline, most of these needs would be concentrated in 2023 (9 bcm, up from 2 bcm in 2022).

Text Table 1. 2022 Fiscal Financing Needs

	In UAH billions	In USD billion	In percent of GDP
Total gross financing needs	**1359**	**41.3**	**29.8**
Fiscal deficit	906	27.5	19.8
Amortization	454	13.8	9.9
Domestic debt	403	12.2	8.8
External debt	51	1.6	1.1
Total financing	**1230**	**37.4**	**26.9**
Domestic debt issuance	505	15.4	11.1
External financing from IFIs and Bilaterals	668	20.3	14.6
Other (one-offs)	0	0.0	0.0
Deposit drawdown (+) / Buildup (-)	57	1.7	1.2
Financing gap	**129**	**4.0**	**2.8**

16. **The 2023 budget will be constrained by the available financing envelope and should take into account stability considerations.** Staff will engage soon with the authorities in the context of the PMB to ensure the voted budget is consistent with reasonable assumptions on domestic and external financing, and helps promote fiscal and external stability. While it is difficult to substantially increase tax revenues in light of the decline in economic activity, allowing sufficient room for priority expenditures will require not just protecting the tax base from further erosion, but also finding avenues to enhance revenue mobilization (including repealing exemptions and payment deferrals under the Martial Law). Broadening the tax base is also critical to meet Ukraine's infrastructure and social development needs. Meanwhile, measures to revive the domestic debt market would alleviate pressure on monetary financing.

17. **Looking ahead, it is crucial to implement policies that do not reverse hard-won gains from past Fund-supported programs to maintain donor confidence and pave the way for the eventual recovery.** Effective transparency and accountability safeguards are critical to sustaining continued donor support, preventing misappropriation, and eventually ensuring high quality reconstruction efforts. Key measures should aim to promote procurement transparency in spending and investment, preserve key functions of the anticorruption enforcement framework, and maintain good corporate governance, including in state-owned enterprises and banks. More broadly, a successful reconstruction effort will require a timely and well-coordinated normalization of fiscal, monetary, and exchange rate policies, restoring financial sector health, gradually liberalizing capital flows, strengthening governance, and tackling key structural challenges, including restoring a well-functioning PFM-system which includes fiscal risk management.

18. **To that end, the authorities are requesting Program Monitoring with Board involvement (see Appendix I).** Discussions on the contours of such a program will start without delay. Fund engagement will provide a strong anchor for macroeconomic policies and further

catalyze donor support, while paving the way for a future Upper Credit Tranche arrangement once conditions permit.[10]

MODALITIES OF FUND FINANCIAL SUPPORT

19. The war has created a large and urgent BOP need that, if left unaddressed, would cause further severe economic disruptions. In particular, Ukraine is experiencing a major shortfall of cereal export receipts: although projections are subject to substantial uncertainty, Ukraine's volume of grains exports is likely to be around 30.5 million metric tons (Mt) in 2022 compared to 50.8 Mt in 2021, resulting in a shock to export receipts of more than US$4 billion, contributing to the large external financing gap. At this scale, the size of the shock (over 3 percent of GDP) substantially exceeds the eligibility threshold of 0.8 percent of GDP for the BOP need associated with a cereal export shortfall. The fiscal deficit contributes to the sizable BOP needs, including because critical current public sector spending has a large import component for fuel, medicines, and parts and equipment to rehabilitate damaged critical infrastructure. Constrained export capacity, loss of international capital market access, capital outflows, FX transactions of Ukrainians migrants, and a drop in foreign direct investment inflows also contribute to the large external financing gap.

Text Table 2. Official Financing
(in US$ billions)

	2022 (proj.)
Underlying BOP gap 1/	**42.0**
Disbursed and prospective official financing 2/	**30.2**
IMF	1.4
Other	28.8
Multilateral	2.6
European Union	10.3
Bilateral loans	3.5
Bilateral grants	10.5
EIB, EBRD, and others	1.8
Remaining Gap	**11.8**
Use of gross reserves	6.5
IMF RFI (Oct. 2022)	1.3
Unidentified fiscal financing need	4.0

1/ Underlying BOP gap indicates the decrease in reserves absent official financing.
2/ Available data on multi- and bilateral commitments as of September 20, 2022.

[10] The PMB will also provide an opportunity to improve data provision, including in the national accounts.

20. Staff assess that Ukraine qualifies for emergency financing under the recently established food shock window of the Rapid Financing Instrument (RFI).[11] Besides the urgent BOP need (see ¶19), the war is constraining the authorities' ability to design an upper credit tranche quality program at the current juncture. Furthermore, access of 50 percent of quota, or SDR 1,005.9 million (about US$1.3 billion), is appropriate given that the size of the cereal export receipt shortfall is substantially larger. The disbursement under the RFI would provide critical support to mitigate the serious consequences of this shock to the export base and play a catalytic role for financing from other partners to close the external financing gap. Under the staff baseline, gross external financing needs currently amount to US$42 billion. Sizable official financing is being provided by the Fund, the World Bank and other IFIs, the European Union, and bilateral G7 partners, among several others, but timely disbursements remain critical.[12] A drain on gross international reserves of US$6.5 billion in 2022, consistent with maintaining reserve coverage above 80 percent of the Fund's ARA metric to mitigate risks to macro-financial stability, would imply a remaining financing gap of US$5.3 billion, of which the proposed purchase would cover US$1.3 billion.

21. With the war ongoing, the financing gap estimates remain subject to significant downside risks. Following a large initial shock, external buffers have stabilized. However, large downside risks are concentrated in the energy and agriculture sectors. Further disruptions to domestic energy supply[13] or a larger-than-expected need to rebuild gas inventories amid high import gas prices could potentially spillover to other industrial and commercial activities. An earlier than expected lapse of the grain export agreement or a slow pace in the recovery of agriculture (46 percent of goods exports over 2017–21) also pose significant downside risks.

22. Additional safeguards are required in view of Ukraine's unprecedented situation. In almost all contexts, debt sustainability, along with the strength of the authorities' policies and a positive assessment of capacity to repay provide the safeguards needed under the Articles of Agreement for Fund lending. Under extreme uncertainty, however, an exceptional case can be made for dividing the approach into a precise safeguard regarding capacity to repay the Fund and a commitment to support medium-term external viability. Unique to the extreme circumstances now prevailing in Ukraine, very high uncertainty makes it difficult, at present, to assess with sufficient precision what would be required to ensure sustainability of Ukraine's debt, but the balance of probabilities suggests that there are higher risks of debt being unsustainable (see Annex I). In conjunction with Ukraine's continued commitment to economic, fiscal and governance reforms as well as strong engagement of all other stakeholders, including International Financial

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[11] See IMF Policy Paper No. 2022/042 "Proposal for a Food Shock Window Under the Rapid Financing Instrument and Rapid Credit Facility"

[12] As of September 20, slightly over two-thirds of the US$30.2 billion in financing commitments for 2022 had been disbursed. The bulk of the pending disbursements relate to the European Union's planned macro-financial assistance. Modalities are now in place to disburse loans totaling EUR 5 billion by December, and the European Commission has indicated that grants of EUR 3 billion will be provided as soon as possible.

[13] In mid-September, the Zaporizhzhia nuclear power was taken offline, costing Ukraine almost a quarter of its electricity generation capacity.

Institutions and the private sector, the bulk of Ukraine's official bilateral creditors and donors undertake to provide financial support on appropriate terms to secure Ukraine's ability to service to the Fund its existing obligations and the amounts proposed under the food shock window of the RFI, in accordance with the Fund's preferred creditor status, and to help Ukraine achieve a balanced growth path and to help restore medium-term external viability. Staff considers that these assurances offer sufficient safeguards to provide financing under the food shock window of the RFI, as a combination of appropriate macroeconomic policies and exceptional financing from Ukraine's creditors and donors would be able to restore medium-term viability under a range of scenarios.

23. Ukraine's capacity to repay the Fund, taking into account these assurances, is adequate but subject to exceptional risks. In order to allay the risks to the Fund from lending to Ukraine under these circumstances, official bilateral donors and creditors have reaffirmed their recognition of the Fund's preferred creditor status in respect of the amounts outstanding to Ukraine, including the requested drawing by Ukraine under the new RFI Food Shock Window. With the proposed purchase under the RFI Food Shock Window, the stock of total Fund credit is expected to peak this year at 4.1 percent of GDP and 23 percent of gross reserves. Debt service to the Fund would peak at 1.2 percent of GDP and 9.8 percent of gross reserves in 2023 and 2025, respectively. A materialization of downside risks would increase these ratios significantly.

24. Official arrears to Russia have not been cleared but are no longer subject to the lending into official arrears (LIOA) policy. In March 2022, Ukraine represented to the Fund a dispute as to the validity of the Eurobond claim held by Russia. These claims are also subject to ongoing litigation before the Supreme Court of England and Wales. There have been no further developments since the March 2022 RFI request.

25. The authorities have committed to undergoing a new safeguards assessment of the NBU. The assessment is to be completed before Board approval of any subsequent arrangement to which the safeguards policy applies. The authorities will also continue providing staff with the NBU's audit reports and authorize its external auditors to hold discussions with staff.

STAFF APPRAISAL

26. Staff supports the authorities' request for Fund emergency financing of 50 percent of quota under the recently established food shock window under the Rapid Financing Instrument (RFI). Ukraine faces unique, extreme circumstances. Staff assesses that Ukraine qualifies for such support given that it is facing an urgent balance of payments need that, if not addressed, would cause severe economic disruptions. The size of the cereal export shortfall exceeds the maximum support available under the food window (i.e., 50 percent of quota), which in Ukraine's case is SDR 1,005.9 million (about US$1.3 billion). The proposed purchase would provide critical and timely support and is expected to act as a catalyst to further official multilateral and bilateral financial assistance. Unique to the extreme circumstances now prevailing in Ukraine, very high uncertainty makes it difficult, at present, to assess with sufficient precision what would be required to ensure sustainability of Ukraine’s debt, but the balance of probabilities suggests that there are higher risks of debt being unsustainable. However, staff considers that the commitments from Ukraine's official bilateral creditors and donors (see ¶22) provide sufficient safeguard assurances for a purchase under the RFI as a combination of appropriate macroeconomic policies and exceptional financing from Ukraine’s creditors and donors would be able to restore medium-term viability under a range of scenarios.

27. The authorities are committed to taking steps to protect macro-financial stability. They intend to remain in close consultation with staff and, to that end, are requesting a PMB to strengthen the nature of their commitment to implement policies that are conducive of macroeconomic and financial stability, foster domestic resource mobilization, and ensure continued donor support, with the aim of paving the way for an eventual full-fledged Fund-supported program when conditions allow it.

Table 1. Ukraine: Selected Economic and Social Indicators, 2019–2022

	2019	2020	2021	2022
	Act.	Act.	Act.	Proj.
Real economy (percent change, unless otherwise indicated)				
Nominal GDP (billions of Ukrainian hryvnias) 1/	3,977	4,222	5,460	4,567
Real GDP 1/	3.2	-3.8	3.4	-35.0
Contributions:				
Domestic demand	3.0	-4.1	12.9	-34.6
Private consumption	8.1	1.2	5.2	-19.3
Public consumption	-2.6	-0.1	0.3	4.9
Investment	-2.6	-5.1	7.4	-20.2
Net exports	0.2	0.3	-9.6	-0.4
GDP deflator	8.2	10.3	25.1	28.6
Output gap (percent of potential GDP)	-0.4	-3.0	-1.2	-8.2
Unemployment rate (ILO definition; period average, percent)	8.5	9.2	9.8	24.5
Consumer prices (period average)	7.9	2.7	9.4	20.6
Consumer prices (end of period)	4.1	5.0	10.0	30.0
Nominal wages (average)	18.5	10.4	20.8	-12.0
Real wages (average)	9.5	7.5	10.5	-27.0
Savings (percent of GDP)	12.2	12.2	12.2	11.1
Private	10.3	14.2	12.4	32.9
Public	1.9	-1.9	-0.2	-21.8
Investment (percent of GDP)	14.9	8.9	13.8	8.4
Private	11.0	4.9	10.0	7.4
Public	3.9	4.0	3.8	1.0
Gross fixed capital formation (percent of GDP)	17.6	13.4	12.4	6.3
General Government (percent of GDP)				
Fiscal balance 2/	-2.1	-5.9	-3.9	-19.8
Fiscal balance, excl. grants 2/	-2.1	-6.0	-4.0	-28.2
External financing (net)	-0.2	2.0	2.4	13.5
Domestic financing (net)	2.3	4.0	1.6	3.5
Public and publicly-guaranteed debt	50.5	61.0	47.6	87.8
Money and credit (end of period, percent change)				
Base money	9.6	24.8	11.2	14.8
Broad money	12.6	28.6	12.0	18.6
Credit to nongovernment	-9.8	-3.1	8.4	8.4
Interbank overnight rate (annual average, percent)	15.6	7.3	6.8	…
Balance of payments (percent of GDP)				
Current account balance	-2.7	3.3	-1.6	2.7
Foreign direct investment	3.4	-0.1	3.4	0.1
Gross reserves (end of period, billions of U.S. dollars)	25.3	29.1	30.9	24.8
Months of next year's imports of goods and services	4.8	4.2	4.5	3.4
Percent of short-term debt (remaining maturity)	53.3	58.6	67.2	60.6
Percent of the IMF composite metric (float)	88.9	98.1	98.8	81.8
Goods exports (annual volume change in percent)	6.4	11.2	34.3	-29.5
Goods imports (annual volume change in percent)	7.2	-3.3	17.2	-24.5
Goods terms of trade (percent change)	4.8	12.0	-5.2	-16.8
Exchange rate				
Hryvnia per U.S. dollar (end of period)	23.7	28.3	27.3	…
Hryvnia per U.S. dollar (period average)	25.8	27.0	27.3	…
Real effective rate (deflator-based, percent change)	14.9	2.0	12.0	…
Memorandum items:				
Real GDP as share of 2021 Real GDP	100.5	96.8	100.0	65.0
Per capita GDP / Population (2017): US$2,640 / 44.8 million				
Literacy / Poverty rate (2022 est 3/): 100 percent / 21 percent				

Sources: Ukrainian authorities; World Bank, World Development Indicators; and IMF staff estimates.

1/ Data based on SNA 2008, exclude Crimea and Sevastopol.

2/ The general government includes the central and local governments and the social funds.

3/ Based on World Bank estimates

Table 2a. Ukraine: General Government Finances, 2019–2022 1/

(Billions of Ukrainian Hryvnia)

	2019	2020	2021	2022
	Act.	Act.	Proj.	Proj.
Revenue	1,567.8	1,675.4	1,982.7	1,914.9
Tax revenue	1,358.6	1,446.4	1,816.8	1,384.7
Tax on income, profits, and capital gains	392.8	413.6	513.6	414.9
Personal income tax	275.5	295.1	349.8	307.9
Corporate profit tax	117.3	118.5	163.8	107.1
Social security contributions	279.1	300.2	350.7	353.7
Property tax	38.0	37.4	43.2	30.7
Tax on goods and services	526.6	565.4	730.8	498.5
VAT	378.7	400.6	536.5	394.8
Excise	137.1	153.9	180.3	99.1
Other	10.9	11.0	14.0	4.6
Tax on international trade	30.1	30.5	38.2	8.4
Other tax	92.1	99.3	140.2	78.5
Nontax revenue	209.2	229.0	165.9	530.1
Grants	1.2	1.2	1.3	384.5
Expenditure	1,650.7	1,925.3	2,198.3	2,820.4
Current	1,492.9	1,750.9	1,986.7	2,752.1
Compensation of employees	439.6	462.8	507.4	925.5
Goods and services	260.4	373.9	482.7	669.1
Interest	120.8	122.2	155.0	161.3
Subsidies to corporations and enterprises	80.9	133.6	116.2	130.6
Social benefits	588.9	657.4	724.5	863.9
Social programs (on budget)	130.1	130.5	153.7	246.7
Pensions	421.0	475.8	518.7	562.3
Unemployment, disability, and accident insurance	37.8	51.2	52.1	54.9
Other current expenditures	2.4	1.1	0.9	1.7
Capital	153.7	169.0	206.9	44.1
Net lending	4.0	5.3	4.8	23.5
Contingency reserve 2/	0.0	0.0	0.0	0.7
General government overall balance	-82.8	-249.9	-215.6	-905.5
General government financing	82.8	249.9	215.6	776.4
External	-9.3	82.8	128.7	616.8
Disbursements	80.2	210.2	239.0	667.8
Amortizations	-89.5	-127.4	-110.3	-51.0
Domestic (net)	92.1	167.1	87.0	159.6
Bond financing 3/	81.5	182.9	68.4	102.2
Direct bank borrowing	1.7	6.7	30.0	0.0
Deposit finance	7.2	-26.2	-18.9	57.0
Privatization	1.6	3.7	7.4	0.4
Financing Gap/unindentified measures (-gap/+surplus)	0.0	0.0	0.0	-129.1
Bank and DGF recapitalization	0.0	0.0	0.0	0.0
Memorandum items:				
Primary balance	38.0	-127.7	-60.7	-615.1
Public and publicly-guaranteed debt	2,008	2,557	2,675	4,011
Nominal GDP (billions of Ukrainian hryvnia)	3,977	4,222	5,460	4,567

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

1/ National methodology, cash basis.

2/ Includes the unallocated portion of expenditures from the COVID fund.

3/ Domestic bonds have been adjusted to reflect discrepancy between the above-the-line and the below-the-line deficits.

Table 2b. Ukraine: General Government Finances, 2019–2022 1/

(Percent of GDP)

	2019	2020	2021	2022
	Act.	Act.	Proj.	Proj.
Revenue	39.4	39.7	36.3	41.9
Tax revenue	34.2	34.3	33.3	30.3
Tax on income, profits, and capital gains	9.9	9.8	9.4	9.1
Personal income tax	6.9	7.0	6.4	6.7
Corporate profit tax	2.9	2.8	3.0	2.3
Social security contributions	7.0	7.1	6.4	7.7
Property tax	1.0	0.9	0.8	0.7
Tax on goods and services	13.2	13.4	13.4	10.9
VAT	9.5	9.5	9.8	8.6
Excise	3.4	3.6	3.3	2.2
Other	0.3	0.3	0.3	0.1
Tax on international trade	0.8	0.7	0.7	0.2
Other tax	2.3	2.4	2.6	1.7
Nontax revenue	5.3	5.4	3.0	11.6
Grants	0.0	0.1	0.0	8.4
Expenditure	41.5	45.6	40.3	61.8
Current	37.5	41.5	36.4	60.3
Compensation of employees	11.1	11.0	9.3	20.3
Goods and services	6.5	8.9	8.8	14.7
Interest	3.0	2.9	2.8	3.5
Subsidies to corporations and enterprises	2.0	3.2	2.1	2.9
Social benefits	14.8	15.6	13.3	18.9
Social programs (on budget)	3.3	3.1	2.8	5.4
Pensions	10.6	11.3	9.5	12.3
Unemployment, disability, and accident insurance	1.0	1.2	1.0	1.2
Other current expenditures	0.1	0.0	0.0	0.0
Capital	3.9	4.0	3.8	1.0
Net lending	0.1	0.1	0.1	0.5
Contingency reserve 2/	0.0	0.0	0.0	0.0
General government overall balance	-2.1	-5.9	-3.9	-19.8
General government financing	2.1	5.9	3.9	17.0
External	-0.2	2.0	2.4	13.5
Disbursements	2.0	5.0	4.4	14.6
o/w IFIs	0.6	1.7	1.4	5.5
o/w IMF budget support	0.0	1.3	0.4	2.0
o/w Other (unidentified)	0.0	0.0	0.0	0.0
Amortizations	-2.3	-3.0	-2.0	-1.1
Domestic (net)	2.3	4.0	1.6	3.5
Bond financing 3/	2.1	4.3	1.3	2.2
Direct bank borrowing	0.0	0.2	0.5	0.0
Deposit finance	0.2	-0.6	-0.3	1.2
Privatization	0.0	0.1	0.1	0.0
Financing Gap/undidentified measures (-gap/+surplus)	0.0	0.0	0.0	-2.8
Bank and DGF recapitalization	0.0	0.0	0.0	0.0
Memorandum items:				
Primary balance	1.0	-3.0	-1.1	-13.5
Public and publicly-guaranteed debt	50.5	61.0	47.6	87.8
Nominal GDP (billions of Ukrainian hryvnia)	3,977	4,222	5,460	4,567

Sources: Ministry of Finance; National Bank of Ukraine; and IMF staff estimates and projections.
1/ National methodology, cash basis.
2/ Includes the unallocated portion of expenditures from the COVID fund.
3/ Domestic bonds have been adjusted to reflect discrepancy between the above-the-line and the below-the-line deficits.

Table 3. Ukraine: Balance of Payments, 2019–2022 1/ 2/

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

	2019 Act.	2020 Act.	2021 Act.	2022 Proj.
Current account balance	-4.2	5.2	-3.2	3.7
Goods (net)	-14.3	-6.9	-6.6	-18.6
Exports	46.1	45.1	63.1	44.2
Imports	-60.4	-52.0	-69.8	-62.8
Of which : gas	-2.8	-1.2	-3.4	-2.7
Services (net)	1.8	4.4	4.0	-4.4
Receipts	17.3	15.6	18.4	15.8
Payments	-15.6	-11.2	-14.4	-20.2
Primary income (net)	1.9	3.5	-5.2	9.0
Secondary income (net)	6.5	4.1	4.6	17.7
Capital account balance	0.0	0.0	0.0	0.1
Financial account balance	-7.9	2.0	-5.0	9.1
Direct investment (net) 3/	-5.2	0.1	-6.9	-0.1
Portfolio investment (net)	-5.1	0.8	-1.0	2.4
Portfolio investment: assets	0.4	0.2	-0.1	0.2
Portfolio investment: liabilities	5.5	-0.7	1.0	-2.3
Financial derivatives (net)	0.0	0.0	0.0	0.0
Other investment (net)	2.4	1.0	2.9	6.8
Other investment: assets	5.9	6.3	7.7	20.8
Other investment: liabilities	3.5	5.3	4.9	14.0
Net use of IMF resources for budget support	-1.0	2.1	0.3	2.3
Central Bank	0.0	0.0	2.7	-1.0
General government	1.0	1.2	1.5	17.6
Banks	-0.3	-0.2	0.4	-1.2
Other sectors	3.8	2.2	0.0	-3.7
Errors and omissions	1.2	0.8	1.8	0.4
Overall balance	4.9	4.0	3.6	-15.3
Financing	-5.1	-4.0	-3.6	4.8
Gross official reserves (increase: -)	-4.5	-2.9	-2.7	6.5
Net use of IMF resources for BOP support	-0.6	-1.1	-0.9	-1.6
Unidentified official financing	0.0	0.0	0.0	0.0
Memorandum items:				
Total external debt (percent of GDP)	78.9	82.3	66.1	99.6
Current account balance (percent of GDP)	-2.7	3.3	-1.6	2.7
Goods and services trade balance (percent of GDP)	-8.2	-1.6	-1.3	-16.6
Gross international reserves	25.3	29.1	30.9	24.8
Months of next year's imports of goods and services	4.8	4.2	4.5	3.4
Percent of the IMF composite metric	88.9	98.1	98.8	81.8

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

1/ Based on BPM6.

2/ Shipments of military equipment in early 2022 are not reflected in the balance of payments pending clarity on modalities. Staff's preliminary understanding is that the support is being provided in the form of unconditional aid and that it will not materially impact the balance of payments in the future.

3/ Includes banks' debt for equity operations.

Table 4. Ukraine: Gross External Financing Requirement, 2019–2022

(Billions of U.S. dollars)

	2019 Act.	2020 Act.	2021 Act.	2022 Proj.
Total financing requirements	41.2	30.9	37.2	47.7
Current account deficit	4.2	-5.2	3.2	-3.7
Portfolio investment	5.6	7.2	4.9	2.7
Private	1.7	1.2	0.6	0.6
General government	3.9	6.0	4.3	2.1
Medium and long-term debt	4.4	4.9	3.9	4.6
Private	3.8	3.5	2.7	2.8
Banks	0.4	0.4	0.2	0.5
Corporates	3.4	3.1	2.5	2.3
General government	0.6	1.4	1.2	1.8
Short-term debt (including deposits)	7.8	3.1	0.8	6.4
Other net capital outflows 1/	5.9	6.3	8.6	20.8
Trade credit	13.3	14.6	15.7	16.9
Total financing sources	45.2	30.6	36.1	19.9
Capital transfers	0.0	0.0	0.0	0.1
Direct investment, net	5.2	-0.1	6.9	0.1
Portfolio investment	10.7	6.3	6.0	0.1
Private	2.6	0.7	1.8	0.0
General government	8.1	5.7	4.2	0.1
Of which: Market financing	2.4	4.6	1.8	0.0
Medium and long-term debt	4.8	4.9	5.4	-7.8
Private	4.0	2.3	2.3	2.6
Banks	1.4	0.3	0.2	0.4
Corporates	2.6	2.0	2.1	2.2
General government	0.8	2.6	3.1	0.0
Short-term debt (including deposits)	10.0	3.3	0.9	3.4
Trade credit	14.5	16.2	16.9	13.5
Increase in gross reserves	4.5	2.9	2.7	-6.5
Errors and omissions	1.2	0.8	1.8	0.4
Total financing needs	-0.8	2.3	1.9	40.1
Official financing	-0.8	2.3	1.7	16.9
IMF	-1.6	1.0	-0.7	0.7
Purchases	0.0	2.1	0.7	2.7
Repurchases	1.6	1.1	1.4	2.1
Official creditors	0.8	1.4	2.3	16.3
World Bank	0.2	0.0	1.3	2.6
EU	0.0	1.3	0.7	10.3
EBRD/EIB/Others	0.6	0.1	0.3	3.3
Unidentified official financing	0.0	0.0	0.0	0.0
Exceptional financing	0.0	0.0	0.0	0.0
Memorandum items:				
Gross international reserves	25.3	29.1	30.9	24.8
Months of next year's imports of goods and services	4.8	4.2	4.5	3.4
Percent of short-term debt (remaining maturity)	53.3	58.6	67.2	60.6
Percent of the IMF composite metric 2/	88.9	98.1	98.8	81.8
Loan rollover rate (percent)				
Banks	97.2	94.2	97.2	80.0
Corporates	101.2	62.6	89.3	90.5
Total	98.6	74.9	91.4	83.8

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

1/ Reflects changes in banks', corporates', and households' gross foreign assets as well as currency

2/ The IMF composite measure is calculated as a weighted sum of short-term debt, other portfolio and investment liabilities, broad money, and exports. Official reserves are recommended to be in the range of 100–150 percent of the appropriate measure.

Table 5. Ukraine: Monetary Accounts, 2019–2022

(Billions of Ukrainian hryvnia unless otherwise noted)

	2019 Act.	2020 Act.	2021 Act.	2022 Proj.
Monetary survey				
Net foreign assets	714	977	1,002	1,088
Net domestic assets	724	873	1,070	1,368
Domestic credit	1,647	1,321	1,392	1,679
Net claims on government	664	368	364	565
Credit to the economy	974	944	1,023	1,109
Domestic currency	616	596	731	866
Foreign currency	358	348	292	242
Other claims on the economy	8	9	5	5
Other items, net	-923	-448	-322	-310
Broad money	1,438	1,850	2,071	2,457
Currency in circulation	384	516	581	666
Total deposits	1,051	1,331	1,489	1,789
Domestic currency deposits	641	837	1,014	1,248
Foreign currency deposits	410	494	474	540
Accounts of the NBU				
Net foreign assets	617	826	852	849
Net international reserves	599	821	838	830
(In billions of U.S. dollars)	25.3	29.0	30.7	…
Reserve assets	599	824	843	907
Other net foreign assets	18	4	14	19
Net domestic assets	-140	-230	-190	-89
Net domestic credit	183	197	175	263
Net claims on government	309	267	270	679
Claims on government	348	337	325	724
Net claims on banks	-126	-70	-95	-416
Other items, net	-323	-426	-365	-351
Base money	477	596	662	761
Currency in circulation	384	516	581	666
Banks' reserves	93	80	81	95
Cash in vault	41	42	47	56
Correspondent accounts	52	38	35	39
Deposit money banks				
Net foreign assets	96	151	149	239
Foreign assets	214	262	254	317
Foreign liabilities	117	111	105	78
Net domestic assets	954	1,180	1,339	1,549
Domestic credit	1,599	1,247	1,342	1,554
Net claims on government 1/	355	102	94	-113
Credit to the economy	974	944	1,023	1,108
Other claims on the economy	8	9	5	5
Net claims on NBU	269	255	316	554
Other items, net	-644	-67	-3	-4
Banks' liabilities	1,051	1,331	1,488	1,789
Memorandum items:	(End of period, percent change unless			
Base money	9.6	24.8	11.2	14.8
Currency in circulation	5.7	34.3	12.6	14.6
Broad money	12.6	28.6	12.0	18.6
Credit to the economy	-9.8	-3.1	8.4	8.4
Real credit to the economy 2/	-13.3	-7.7	-1.5	-16.6
Credit-to-GDP ratio, in percent	24.5	22.5	0.0	24.3
Velocity of broad money, ratio	2.8	2.1	1.9	1.9
Money multiplier, ratio	3.0	3.1	3.1	3.2
Hryvnia per U.S. dollar (end of period)	23.7	28.3	27.3	…

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

1/ Includes claims for recapitalization of banks.

2/ Deflated by CPI (eop), at current exchange rates, year-on-year percent change.

Table 6. Ukraine: Indicators of Fund Credit, 2019–2027
(In millions of SDR)

	2019	2020	2021	2022	2023	2024	2025	2026	2027
	Actual	Actual	Actual	Projections					
Existing Fund credit									
Stock 1/	6,883	7,595	6,626	6,602	4,698	2,918	1,182	187	0
Obligations 2/	1,408	994	1,152	434	2,194	1,957	1,845	1,064	195
Principal (repurchases)	1,153	788	969	186	1,905	1,780	1,736	995	187
Stock of existing and prospective Fund credit 1/ 2/	6,883	7,595	6,626	7,608	5,704	3,924	2,187	690	0.0
In percent of quota 3/	342	378	329	378	284	195	109	34	0.0
In percent of GDP	3.2	3.4	2.4	4.1	3.0	1.9	1.0	0.3	0.0
In percent of exports of goods and nonfactor services	7.9	8.7	5.8	9.6	6.5	4.0	2.3	0.7	0.0
In percent of gross reserves	19.7	18.1	15.3	23.2	18.0	14.4	11.4	4.1	0.0
In percent of public external debt	10.7	10.3	9.3	8.4	5.6	3.7	2.1	0.7	0.0
Obligations to the Fund from existing and prospective Fund credit 2/	1,408	994	1,152	443	2,253	2,013	1,876	1,590	706
In percent of quota	70.0	49.4	57.3	22.0	112.0	100.1	93.3	79.0	35.1
In percent of GDP	0.7	0.4	0.4	0.2	1.2	1.0	0.9	0.7	0.3
In percent of exports of goods and nonfactor services	1.6	1.1	1.0	0.6	2.6	2.1	1.9	1.6	0.7
In percent of gross reserves	4.0	2.4	2.7	1.3	7.1	7.4	9.8	9.5	4.0
In percent of public external debt service	22.8	12.8	19.6	6.3	44.8	20.2	18.8	16.0	7.1

Source: Fund staff estimates and projections.

1/ End of period.
2/ Repayment schedule based on repurchase obligations and GRA charges. Includes service charges.
3/ Ukraine's quota is SDR 2011.8 million effective since February 2016.

Annex I. Debt Sustainability Analysis

Ukraine faces risks and uncertainties related to external developments, the hazardous security situation, and the implementation of the authorities' policy commitments. The balance of probabilities suggests that there are higher risks of debt being unsustainable. However, unique to the extreme circumstances now prevailing in Ukraine, very high uncertainty makes it difficult, at present, to assess with sufficient precision what would be required to restore sustainability. It is, however, clear that debt vulnerabilities would be contained if Ukraine were to receive a sufficiently large financing envelope to address the severe impacts of the war, and if this support comes in the form of highly concessional loans and other exceptional financing.

1. The war in Ukraine has been more protracted than initially expected, necessitating substantial revisions to the baseline assumptions underpinning this DSA. The March 2022 DSA, which was prepared in the first weeks of the Russian invasion, flagged that the baseline projections were subject to unusually large uncertainty (see IMF Country Report No. 2022/074), and downside risks to the size of the shock have since materialized. With the macroeconomic situation stabilizing in the very near-term, it is possible to present a reasonably robust baseline forecast for 2022, which captures the impact of the shock on key macroeconomic variables, including GDP growth, the fiscal balance, the exchange rate, borrowing costs, and financing. The result is a substantial step increase in the debt-to-GDP ratio in 2022 and elevated gross financing needs. Although near-term vulnerabilities are very high, amid continuing uncertainty around the timing of external financing disbursements, the risks appear to be becoming more contained given the scale of the financing commitments in place, the agreed debt service suspension, and the authorities' wartime economic measures.

2. The medium-term forecast for Ukraine is subject to unusually large and unique uncertainties, as there are several plausible but widely differing scenarios that would yield varying debt and GFN trajectories and it is hard to settle on one baseline. This reflects the need to make assumptions on issues such as the duration and severity of the war, additional damage Ukraine may suffer, the impact on Ukraine's capacity to export goods, the rate at which migrants return to the country, and the pace at which fiscal policy can be normalized. Conversely, it is premature at this stage to incorporate into the macroeconomic outlook robust assumptions on a very large recovery and reconstruction plan, since the design and financing of that plan is still a work in progress, and its timing rests on developments of the war. In its place, the baseline forecast makes a relatively modest assumption that cumulative external concessional financing to Ukraine in 2023–24 would be of similar size as that expected in 2022 (i.e., totaling around US$30 billion for the two years, with frontloading).[1] A scenario explicitly incorporating a reconstruction strategy would entail substantially larger financing and would have a major impact on growth prospects, and all the key variables that guide any assessment of Ukraine's forward-looking debt carrying capacity.

[1] In the absence of firm commitments at this early stage, the 2023 baseline assumes external financing of about two-thirds of its 2022 level and does not incorporate a large reconstruction effort.

3. **The impact of the war thus far, coupled with these considerations, have informed staff's assessment**. Specially, the balance of probabilities would suggest that Ukraine has an unsustainable level of debt. However, unique to the extreme circumstances now prevailing in Ukraine, very high uncertainty makes it difficult, at present, to estimate with sufficient precision the impact of the war on the debt outlook, and what would be required to restore sustainability.

4. **The DSA presents the standardized analytical tools in the accompanying Sovereign Risk and Debt Sustainability Framework for Market Access Countries (SRDSF), which helps assess sovereign stress risks and debt sustainability, although it cannot capture the range of uncertainty and the structural break arising from the war**. The analytical measures are derived from debt and gross financing needs simulations based on baseline macroeconomic projections over a medium-term horizon, and drawing conclusions informed by Ukraine's economic performance in recent years. The simulations in the SRDSF framework are based a single baseline, whereas a case can be made for other plausible baselines, potentially providing a range of signals. Further, these simulations are mainly informed by historical observations, which do not account for with the major structural break posed by the war shock and may be less informative. Finally, long-term modules have been omitted given projection uncertainties, which could omit important information (such a reconstruction). These caveats aside, this DSA clearly highlights the continuing need for large-scale financial support to address the severe impacts of the war, and that this be in the form of grants, highly concessional loans, and/or debt relief to contain vulnerabilities to debt sustainability. Moreover, the scale of risks is exemplified by the unusually large width of the debt fan chart under this DSA.

Annex Table I.1. Ukraine: Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	…	**High**	The overall risk of sovereign stress is high, reflecting high vulnerabilites in the medium-term horizon.
Near term 1/	n.a.	n.a.	Not applicable
Medium term	**High**	**High**	Medium-term risks are assessed as high, consistent with the mechanical high risk signals from both the debt fan chart and the GFN modules. The fanchart indicates very high uncertainty around the debt trajectory, and financeability tool finds high liquidity risks compared to relevant comparators.
Fanchart	**High**	…	
GFN	**High**	…	
Stress test	…	…	
Long term	…	**High**	The long-term modules have not been activated, given high uncertainty and data gaps. Future DSAs will need to investigate changes to Ukraine's demographic structure due to the war, notably through large scale movements of refugees, and any potential impact on the sustainability of public pensions.
Sustainability assessment 2/	Unsustainable	The balance of probabilities suggests that Ukraine has an unsustainable level of debt. However, unique to the extreme circumstances now prevailing in Ukraine, very high uncertainty makes it difficult, at present, to estimate with sufficient precision what would be required to restore sustainability	While the balance of probabilities suggests that Ukraine has an unsustainable level of debt., medium term external viability would be restored with eventual normalization of the security situation, and a combination of policy commitments, safeguards assurances from major creditors, and exceptional financing from Ukraine's creditors and donors
Debt stabilization in the baseline			No

DSA Summary Assessment

Commentary: Unique to the extreme circumstances now prevailing in Ukraine, very high uncertainty makes it difficult, at present, to assess with sufficient precision what would be required to ensure sustainability of Ukraine's debt, but the balance of probabilities suggests that there are higher risks of debt being unsustainable.Medium term external viability would be restored with eventual normalization of the security situation, and a combination of policy commitments, safeguards assurances from major creditors, and exceptional financing from Ukraine's creditors and donors.

Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.
1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.
2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Annex Figure I.1. Ukraine: Debt Coverage and Disclosures

						Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?					n.a.	
2. Subsectors included in the chosen coverage in (1) above:						

Coverage	#	Subsectors captured in the baseline	Inclusion	Comments
CPS / NFPS / GG: expected / CG	1	Budgetary central government	Yes	
CPS / NFPS / GG: expected / CG	2	Extra budgetary funds (EBFs)	No	Not applicable
CPS / NFPS / GG: expected / CG	3	Social security funds (SSFs)	Yes	
CPS / NFPS / GG: expected	4	State governments	Yes	
CPS / NFPS / GG: expected	5	Local governments	Yes	
CPS / NFPS	6	Public nonfinancial corporations	Yes	
CPS	7	Central bank	Yes	
CPS	8	Other public financial corporations	Yes	

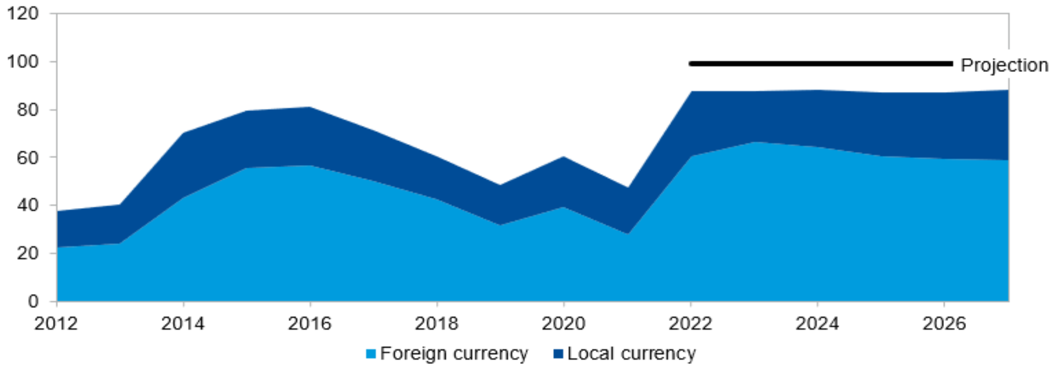
3. Instrument coverage:	Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/
4. Accounting principles:	Basis of recording		Valuation of debt stock		
	Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Commentary: This DSA is based on end-2021 debt stock estimates. As previously, the coverage of public debt includes: (i) central government direct debt; (ii) domestic and external government-guaranteed debt (loans and bonds) extended to state-owned enterprises (SOEs); (iii) debt of local governments; and (iv) Ukraine's liabilities to the IMF that are not included in central government direct debt. It does not include non-guaranteed domestic and external liabilities of SOEs. Data concering debt consolidation across sectors is not available.

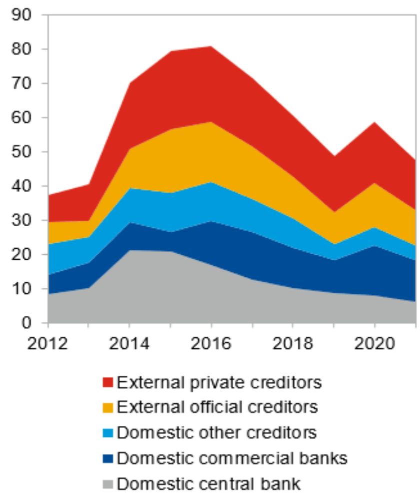
Annex Figure I.2. Ukraine: Public Debt Structure Indicators

Debt by Currency (Percent of GDP)



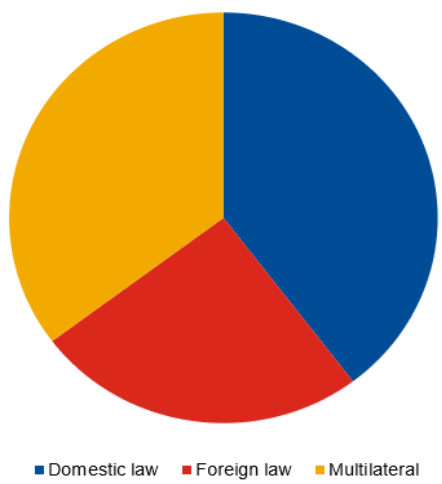
Note: The perimeter shown is general government.

Public Debt by Holder (Percent of GDP)



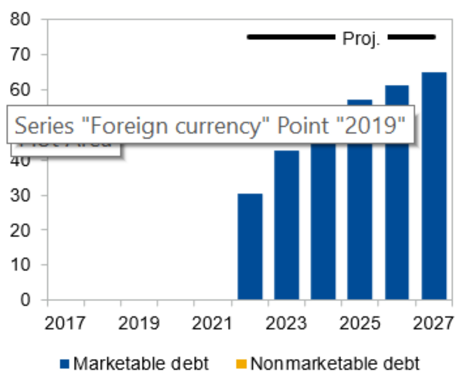
Note: The perimeter shown is general government.

Public Debt by Government Law, June 2022 (Percent)



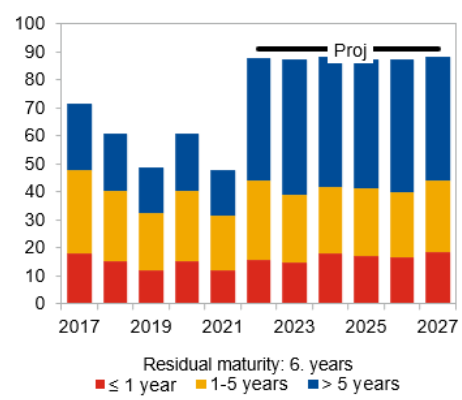
Note: The perimeter shown is general government.

Debt by Instruments (Percent of GDP)



Note: The perimeter shown is general government.

Public Debt by Maturity (Percent of GDP)



Note: The perimeter shown is general government.

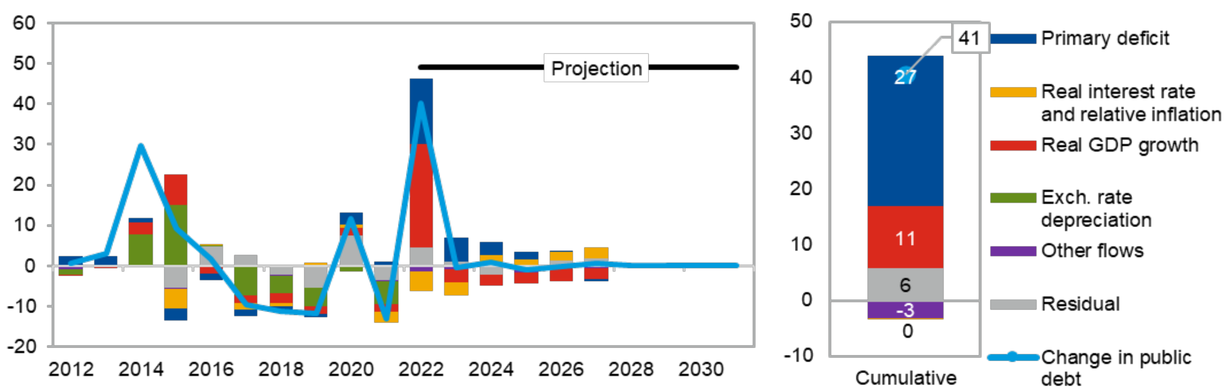
Commentary: This DSA does not anticipate major forward-looking changes in the composition of debt by currency. Data on the debt structure situation is available for end-June 2022, which indicates that externally held debt accounted for slightly over half (56 percent) of total public and publicly guaranteed debt. Multilateral creditors and sovereign Eurobonds account for the bulk of this, or 23 and 21 percent of total debt, respectively. Domestic debt is mostly held by residents and denominated in hryvnia.

Annex Table I.2. Ukraine: Baseline Scenario

(Percent of GDP unless indicated otherwise)

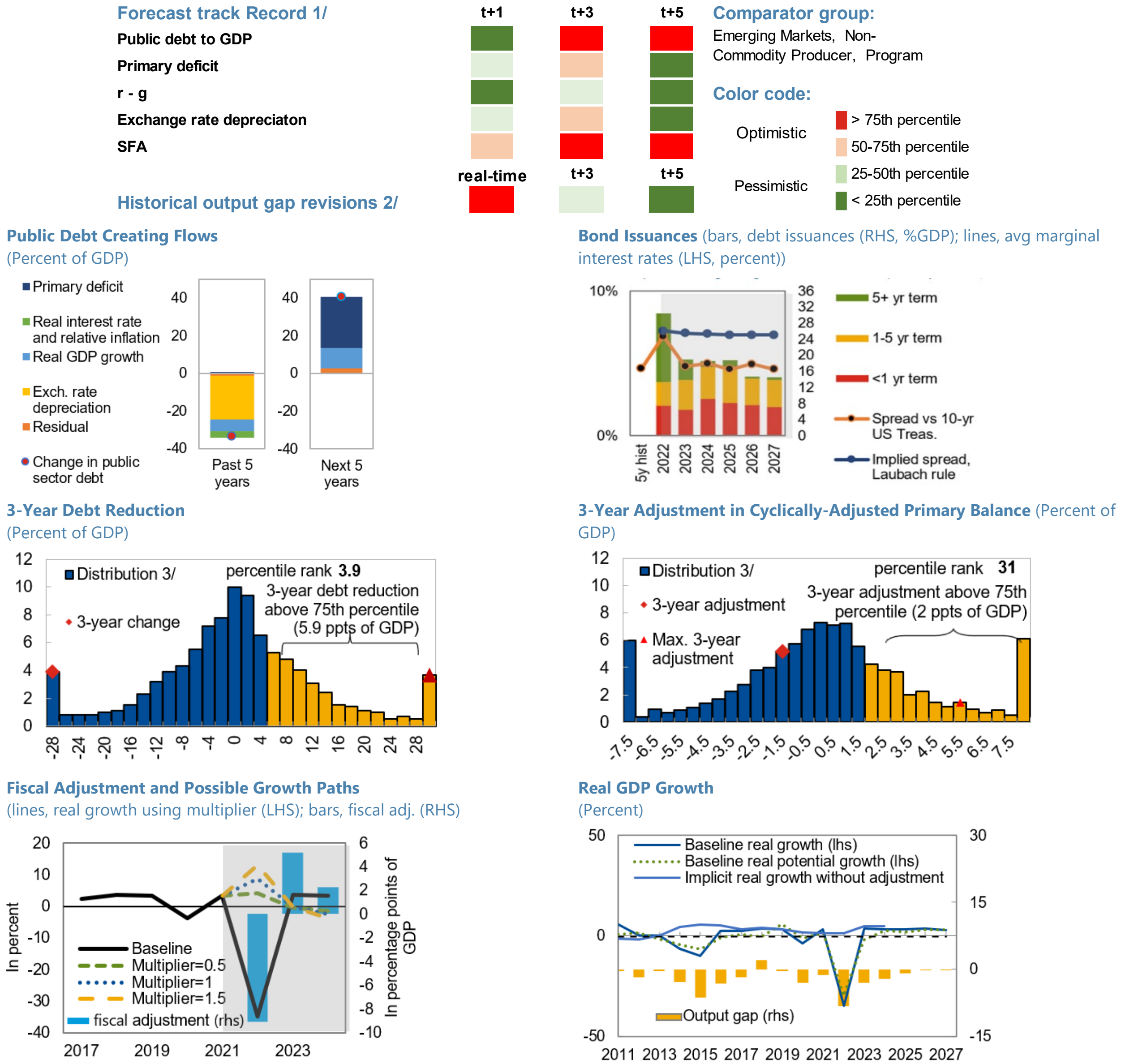
	Actual	Medium-term projection						Extended projection			
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Public debt	47.6	87.8	87.5	88.3	87.4	87.4	88.1	n.a.	n.a.	n.a.	n.a.
Change in public debt	-13.0	40.2	-0.4	0.9	-0.9	0.0	0.8	n.a.	n.a.	n.a.	n.a.
Contribution of identified flows	-9.4	35.7	-1.5	2.9	0.0	-1.3	-1.0	n.a.	n.a.	n.a.	n.a.
Primary deficit	1.1	16.3	5.8	3.2	1.9	0.4	-0.6	n.a.	n.a.	n.a.	n.a.
Noninterest revenues	36.3	41.9	41.9	39.7	38.5	38.7	39.6	n.a.	n.a.	n.a.	n.a.
Noninterest expenditures	37.4	58.2	47.7	42.8	40.3	39.1	39.1	n.a.	n.a.	n.a.	n.a.
Automatic debt dynamics	-10.4	20.7	-6.4	-1.1	-1.2	-1.1	0.1	n.a.	n.a.	n.a.	n.a.
Real interest rate and relative inflation	-2.7	-4.9	-3.4	1.7	1.6	2.1	2.6	n.a.	n.a.	n.a.	n.a.
Real interest rate	-9.0	-13.2	-14.6	-5.7	-2.8	-0.3	1.0	n.a.	n.a.	n.a.	n.a.
Relative inflation	6.3	8.4	11.2	7.4	4.4	2.4	1.6	n.a.	n.a.	n.a.	n.a.
Real growth rate	-2.0	25.6	-3.0	-2.9	-2.8	-3.2	-2.5	n.a.	n.a.	n.a.	n.a.
Real exchange rate	-5.8	…	…	…	…	…	… .	…	…	…	…
Other identified flows	-0.1	-1.3	-0.9	0.9	-0.7	-0.6	-0.6	n.a.	n.a.	n.a.	n.a.
Contingent liabilities	0.0	0.0	0.0	1.7	0.0	0.0	0.0	n.a.	n.a.	n.a.	n.a.
Other transactions	-0.1	-1.3	-0.9	-0.8	-0.7	-0.6	-0.6	n.a.	n.a.	n.a.	n.a.
Contribution of residual	-3.5	4.5	1.1	-2.1	-0.9	1.3	1.8	n.a.	n.a.	n.a.	n.a.
Gross financing needs	5.9	29.7	21.5	22.4	21.7	19.3	18.7	n.a.	n.a.	n.a.	n.a.
of which: debt service	4.8	13.4	15.6	17.6	19.8	18.9	19.2	n.a.	n.a.	n.a.	n.a.
Local currency	n.a.	8.7	12.5	10.9	13.0	13.0	12.6	n.a.	n.a.	n.a.	n.a.
Foreign currency	n.a.	4.7	3.2	6.7	6.8	5.9	6.6	n.a.	n.a.	n.a.	n.a.
Memo:											
Real GDP growth (percent)	3.4	-35.0	3.5	3.4	3.2	3.8	3.0	n.a.	n.a.	n.a.	n.a.
Inflation (GDP deflator; percent)	25.1	28.6	27.3	16.0	10.0	6.5	5.0	n.a.	n.a.	n.a.	n.a.
Nominal GDP growth (percent)	29.3	-16.3	31.7	19.9	13.6	10.6	8.2	n.a.	n.a.	n.a.	n.a.

Contribution to Change in Public Debt (Percent of GDP)



Commentary: The war leads to a step rise in Ukraine's debt-to-GDP ratio. Forward-looking assumptions are highly tentative. The DSA assumes war impacts declining, and front-loaded, concessional financial support through 2024. Debt service assumptions include the August 2022 debt service standstill agreed with private bondholders and warrant holders, but not the recent bilateral standstill, for which data is pending. The standstill results in a low effective interest rate in 2022-23, which then jumps once postponed payments resume. The baseline sees a subdued recovery, with inflation slowing over time. The interest rate-growth differential offsets slow fiscal adjustment, given headwinds from elevated spending pressure. This leads to a flat medium-term debt trajectory.

Annex Figure I.3. Ukraine: Realism of Baseline Assumptions



Commentary: The forecast track record, based on Ukraine's history, point to persistent optimism for the debt-to-GDP and stock-flow adjustment indicators in the medium-term horizon. However, the scale of the war shock and uncertainities about its duration, necessitates caution in assessing the realism of baseline forecast. The key debt drivers will be the primary deficit, given high defense spending in the near term, and a likely sluggish recovery. Monetization drives maginal interest rates higher in 2022.The three-year fiscal adjustment based on 2021-24 seems feasible, although this critically depends on the duration of the war and the speed at which the very large deficit that arose in 2022 can be reversed. Ukraine has previously achieved a relatively large fiscal adjustment of 5.5 percent of GDP, although this will face considerable headwinds from a slow recovery. Assumptions on multipliers and the pace at which the output gap closes are conservative.

Source : IMF Staff.

1/ Projections made in the October and April WEO vintage.

2/ Data cover annual obervations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

3/ Starting point reflects the team’s assessment of the initial overvaluation from EBA (or EBA-Lite).

4/ The Lauback (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

5/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates and final estimates in the latest October WEO) in the total distribution of revisions across the data sample.

Annex Figure I.4. Ukraine: Medium-term Risk Analysis

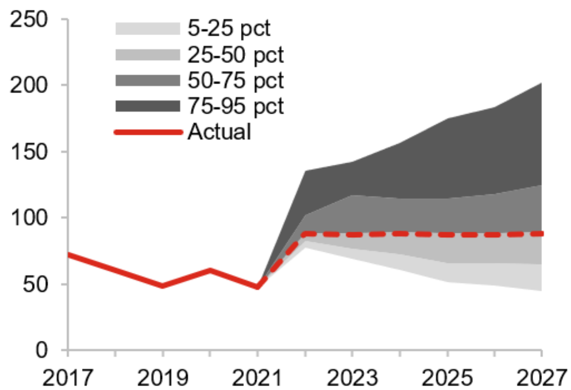
Debt Fan Chart and GFN Financeability Indexes (Percent of GDP unless otherwise indicated)

Module	Indicator	Value	Risk index	Risk signal
Debt fanchart module	Fanchart width	157.3	2.3	…
	Probability of debt not stabilizing (pct)	45.1	0.4	…
	Terminal debt level x institutions index	60.6	1.3	…
	Debt fanchart index	**…**	**4.0**	**High**
GFN finance-ability module	Average GFN in baseline	22.2	7.6	…
	Bank claims on government (pct bank assets)	27.3	8.8	…
	Chg. in claims on govt. in stress (pct bank assets)	63.9	21.4	…
	GFN financeability index	**…**	**37.8**	**High**

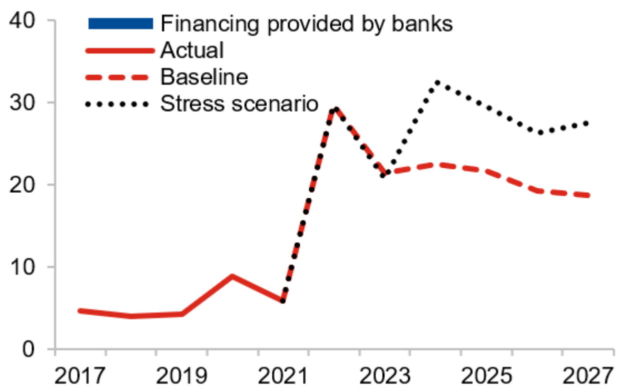
Adv. Econ., Non-Com. Exp, Program: 0, 25, 50, 75, 100

Legend: Interquartile range; Ukraine

Final Fan Chart (Percent of GDP)



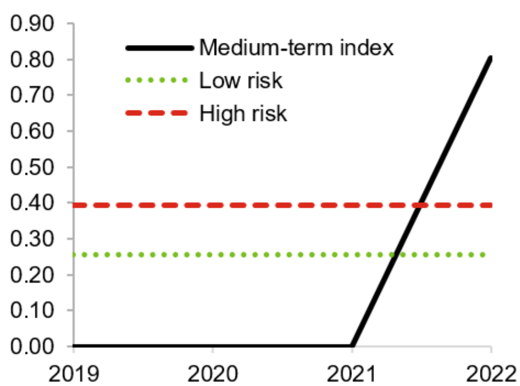
Gross Financing Needs (Percent of GDP)



Triggered stress tests (stress tests not activated in gray)

Banking crisis | Commodity prices | Exchange rate | Contingent liab. | Natural disaster

Medium-term Index (Index number)



Medium-term Risk Analysis

	Low risk threshold	High risk threhsold	Weight in MTI	Normalized level
Debt fanchart index	1.1	2.1	0.5	0.9
GFN finaceability index	7.6	17.9	0.5	0.7
Medium-term index (MTI)	0.3	0.4	…	0.8, High

Prob. of missed crisis, 2022-2027 (if stress not predicted): 100.0 pct.

Prob. of false alarm, 2022-2027 (if stress predicted): 0.0 pct.

Commentary: Both medium-term modules signal high sovereign stress risks. The high risk signal for fanchart width points to a structural break and very high uncertainty around the forecast. The fanchart also suggests high probability that debt-carrying capacity is stretched. The GFN stress tests find persistently high financing needs, especially in the near term, as well as limited scope for banks to absorb government debt. As a result, the mechanical signal substantially exceeds the high risk threshold.

Appendix I. Letter of Intent

Ms. Kristalina Georgieva October 1, 2022

Managing Director

International Monetary Fund

Washington, D.C., 20431

U.S.A.

Dear Ms. Georgieva:

1. The Ukrainian authorities are grateful for the support provided by the IMF since the Russian invasion of our country on February 24. The disbursement of SDR 1,005.9 million (about US$1.4 billion) under the Rapid Financing Instrument on March 9, in the early days of the war, provided critical support at a time of acute financial stress. The subsequent establishment of an IMF Administrative Account has successfully channeled more than US$2 billion of additional funds to Ukraine. In parallel, close collaboration on assessing financing needs has been crucial in catalyzing unprecedented financial assistance from donors.

2. Ukraine continues to suffer from the dramatic consequences of the Russian invasion. In addition to a large loss of life, over a third of Ukrainians have either left the country or been internally displaced, and infrastructure damage is estimated at around 60 percent of 2021 GDP. Against this background, GDP is projected to collapse by more than a third this year, and the outlook for next year remains highly dependent on the length and intensity of the war.

3. We have adjusted our macroeconomic policies forcefully to this unprecedented shock. In addition to the emergency measures undertaken immediately following the outbreak of the war, the devaluation of the exchange rate in July, following an increase in the NBU key policy rate from 10 to 25 percent in June, together with a tightening in capital controls, have been successful in helping to buoy international reserves. On the fiscal side, we have compressed non-priority expenditures and reoriented spending towards critical needs and in support of our defense effort and our citizens most affected by the war. NBU purchases of government war bonds on the primary market have been largely sterilized and base money growth has remained contained. Overall, in spite of very challenging circumstances, we have managed to maintain macroeconomic stability and the financial sector demonstrated has resilience.

4. Despite all these efforts and large scale external official multilateral and bilateral support, for which we are very thankful, our balance of payments and fiscal financing needs remain large, including on the back of a major shortfall of cereal export receipts. Unfortunately, our financing needs are also subject to significant risks. A prolonged war would exacerbate infrastructure damage, population displacement, economic hardship, and an increase in poverty. Renewed loss of port access could jeopardize future agriculture seasons, affecting exports and global food security. Further pressure on gas stocks and contingent liabilities from state-owned enterprises in the energy sector as well as from the banking sector could add to already large financing needs.

5. Against this background, we are requesting financial assistance from the IMF under the food shock window of the Rapid Financing Instrument (RFI) in the amount equivalent of SDR 1,005.9 million, corresponding to a purchase of 50 percent of Ukraine's quota. Furthermore, we request that the purchase be disbursed into Ukraine's SDR holdings account. Should we ultimately use RFI funds for budget support, we commit to put in place a memorandum of understanding between the National Bank of Ukraine (NBU) and the Ministry of Finance that clarifies the responsibilities for timely servicing of our financial obligations to the IMF. This IMF assistance will help meet urgent balance of payments needs arising from the consequences of the war, which, if not addressed, would result in immediate and severe economic disruption. We expect the RFI support to have a significant catalytic effect as we seek additional official financing to close our residual financing gap for 2022.

6. We will provide adequate and timely data and continue to collaborate closely with the IMF when designing and implementing policy measures. We remain committed to sound economic, fiscal and governance reforms to protect macro-financial stability. To that end, we herewith also request a Program Monitoring with Board involvement (PMB), which we expect would help eventually pave the way for an Upper Credit Tranche arrangement in the near future. The Fund's support under the PMB will provide a strong anchor for assessing financing needs and coordinating and implementing policies that support macroeconomic stability and continued donor support.

7. We do not intend to introduce or intensify exchange and trade restrictions and other measures or policies that would compound Ukraine's balance of payments difficulties. We will gradually remove restrictions as our situation eventually normalizes, in consultation with IMF staff.

8. In line with IMF safeguards policy, we commit to undergoing a new safeguards assessment of the National Bank of Ukraine and will continue providing IMF staff with the NBU's audit reports and authorize its external auditors to hold discussions with staff.

9. We authorize the IMF to publish this letter and the accompanying Executive Board documents immediately upon consideration by the IMF's Executive Board of our request for a purchase under the food shock window of the RFI.

Sincerely yours,

/s/	/s/
Sergii Marchenko	Kyrylo Shevchenko
Minister of Finance of Ukraine	Governor, National Bank of Ukraine

Statement by Vladyslav Rashkovan, Alternate Executive Director for Ukraine

October 7, 2022

The unprovoked, unjustified, and illegal invasion by Russia, which started on February 24, 2022, has taken an enormous human, social, and economic toll on Ukraine.

The Ukrainian authorities sustained the exceptional-sized **macro shock, and managed** to keep all government institutions fully functioning, the financial sector liquid and well-capitalized, payment systems functioning normally and online banking services fully available to all clients, banks branches operational, and, revenue administration, the court system, law enforcement, and anticorruption agencies working.

The coordinated policy mix addressed the biggest elements of policy uncertainty and helped the government adapt to the new war realities as economic conditions evolved. The economic policies during the seven months of the war, implemented with close cooperation with the Fund's staff, were well-crafted to address the macro spillovers of Russia's invasion.

Ukraine's economic resilience has been one of the major outcomes of the previous IMF-funded programs. Nevertheless, the reserves of economic resilience are depleting: Ukraine's population has been profoundly impacted by the war, and infrastructure damage is colossal and increasing. The war has led to millions of refugees and internally displaced people, and an increase in unemployment and poverty.

The war also led to imbalances in the FX market and depreciation expectations are still high. Although retail hryvnia deposits increased by ~25% versus the start of the invasion, demonstrating households' trust in the banking sector and the National Bank of Ukraine, **credit risk is rising, and banks' asset quality is deteriorating**. Banks granted payment holidays on retail and corporate loans for the duration of the Martial Law and canceled some fees and commissions, which affects banks' profitability. The authorities are committed to ensuring macro-financial stability and urgently restoring the equilibrium of the balance of payments.

The authorities identified some internal resources to address the current government expenditures increases, driven by urgent social spending and other critical needs, including restoring basic livelihoods in war-affected areas – via raising taxes (e.g., inflationary tax), reducing other expenditures, and other policy measures. However, due to Russia partially blocking the seaports, **export and import capacity are restraint,** leading to a shortfall in grain export, contributing to the external financing gap, and hampering the much-needed import for critical current public sector spending, like fuel, medicines, and parts and equipment to rehabilitate the damaged critical infrastructure.

Several policy actions have already been taken by the authorities to balance the fiscal risks and narrow the financing gap. Sizeable grants and loans from international partners positively impacted the Ukrainian economy. Successful liquidity management operations by the government and coordinated suspension of debt service due by Ukraine substantially improved the debt sustainability of Ukraine.

While the major uncertainties of the first macro shock are gone, Ukraine now needs to focus on macroeconomic adjustments in the extended war-related economic circumstances. The Fund is the ultimate expert to support Ukraine in this endeavor, and its advice and further emergency support are needed now more than ever. The next policy steps should assist in the return to the normal state of the financial system, and in restoring the predictability of the medium-term budget and tax policies, including reducing quasi-fiscal energy risks.

The authorities understand that it is important to **implement policies that do not reverse the hard-won gains from past Fund-supported programs** and remain committed to safeguarding transparency and accountability, critical to sustaining continued donor support, preventing misappropriation, and ensuring high-quality reconstruction efforts. The authorities have provided assurances of full program ownership across government institutions and are committed to undergoing a new safeguards assessment of the National Bank of Ukraine.

Against this background, the authorities have requested financial assistance from the Fund under the food shock window of the Rapid Financing Instrument (RFI). This IMF assistance will help meet the urgent balance of payments needs arising from the consequences of the war, which, if not addressed, would result in an immediate and severe economic disruption. The authorities believe that RFI support will become a catalyst for other donors and partners to support Ukraine in 2022, and beyond. The authorities thank the major donors for providing safeguard assurances, given their criticality for this emergency financing. The Fund has always been a partner of Ukraine in times of crisis, and the new emergency financing is an essential element to enable the rebalancing of the balance of payment needs.

The authorities also requested Program Monitoring with Board involvement, which should pave the way for an Upper Credit Tranche arrangement early next year. The Fund's support under the PMB will provide a strong anchor for assessing financing needs and coordinating and implementing policies that support macroeconomic stability and continued donor support.