INTERNATIONAL MONETARY FUND

IMF Country Report No. 22/387

UKRAINE

December 2022

PROGRAM MONITORING WITH BOARD INVOLVEMENT—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR UKRAINE

In the context of Program Monitoring with Board Involvement, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Acting Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on December 19, 2022, following discussions on November 22, 2022, with the officials of Ukraine on economic developments and policies underpinning the IMF arrangement under the Program Monitoring with Board Involvement. Based on information available at the time of these discussions, the staff report was completed on December 12, 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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PRESS RELEASE

PR 22/446

IMF Board discusses Program Monitoring with Board involvement (PMB) for Ukraine

FOR IMMEDIATE RELEASE

Washington, DC – December 19, 2022

- The IMF Executive Board discussed Program Monitoring with Board involvement (PMB) for Ukraine.
- The 4-month PMB, which has been approved by IMF Management, is designed to help Ukraine maintain stability and catalyze donor financing amid very large balance of payment needs and exceptionally high risks.
- Key measures under the PMB include enhancing revenue mobilization and reviving the domestic debt market, preparing a financial sector strategy, and enhancing transparency and governance .

The Executive Board of the International Monetary Fund discussed today a Management-approved PMB for Ukraine. [1] This 4-month PMB is designed to help Ukraine maintain stability and catalyze donor financing.

At the conclusion of the Executive Board's discussion, Ms. Gita Gopinath, First Deputy Managing Director and Acting Chair, made the following statement:

"Russia's invasion continues to have a devastating social and economic impact on Ukraine. Civilian casualties are mounting, over a third of the population has been displaced, access to basic needs such as electricity, water, and heating is at risk, and the destruction of housing, infrastructure, and productive capacity has been massive. As a result, economic activity has severely contracted, inflation remains high, and public finances are under extreme pressure.

"Notwithstanding all these strains, the authorities have largely managed to maintain macroeconomic and financial stability, and they are committed to continue adapting policies to fast changing circumstances, including in the case of a severe downside scenario. Balance of payment needs remain very large and risks are exceedingly high.

"Against this background, management has approved the authorities' request for Program Monitoring with Board Involvement (PMB). The PMB is tailored to Ukraine's exceptional circumstances, to help the authorities implement prudent macroeconomic policies during this particularly difficult period and catalyze donor financing. Large and predictable external

[1] IMF policy was recently modified to allow for Program Monitoring with Board involvement (PMB).https://www.imf.org/en/News/Articles/2022/10/05/pr22335-imf-approves-a-new-food-shock-window-and-an-enhanced-staff-monitored-program

financial support will be critical for the success of the authorities' strategy, and frontloaded disbursements would help address strains in early 2023.

"The PMB focuses on a targeted set of policy actions to support macroeconomic and financial stability. This will require enhancing revenue mobilization, containing monetary financing and therefore reviving domestic debt markets. At the same time, the PMB seeks to promote transparency and preserve hard-won gains from past Fund-supported programs, including in the areas of independence of the National Bank of Ukraine and, more broadly, governance and anti-corruption. Strong implementation of the PMB should help pave the way toward a possible full-fledged IMF-supported program.''

INTERNATIONAL MONETARY FUND

UKRAINE

PROGRAM MONITORING WITH BOARD INVOLVEMENT

December 12, 2022

EXECUTIVE SUMMARY

Russia's invasion of Ukraine continues to have a devastating social and economic impact on the country. Civilian casualties are mounting, over a third of the population has been displaced, and access to basic needs such as electricity, water, and heating are at risk while winter is coming. Macroeconomic management has been exceedingly difficult. The fiscal deficit has ballooned to accommodate a large expansion of defense spending, financed by a combination of external support and monetization, with multiple supplementary budgets since the start of the war. The inflation targeting regime was replaced by a hard peg to the US dollar, supported by FX controls and a sizeable increase in policy interest rates. The exchange rate has come under episodic pressure (and was devalued by 25 percent in July), despite sizable external financing. Notwithstanding all these strains, the authorities have largely managed to maintain macroeconomic and financial stability, and they are committed to take necessary measures to preserve stability.

Risks remain exceedingly high. The next few months look extremely challenging due to sustained attacks on critical civilian infrastructure. Accordingly, while staff's central scenario assumes economic stabilization in 2023, the range of plausible scenarios is extremely wide. The scale of the uncertainties underscores the need for contingency planning to enable the authorities to continue responding to shocks.

The authorities have requested a 4-month PMB, tailored to their exceptional circumstances, to help them implement macroeconomic policies during this particularly difficult period and catalyze donor financing. The authorities' main objective under the PMB is to ensure adequate resources for core functions of the state, above all defense, while taking measures to maintain macroeconomic and financial stability. This will also require enhancing revenue mobilization, containing monetary financing and therefore reviving domestic debt markets. At the same time, the PMB will seek to promote transparency and preserve hard-won gains from past Fund-supported programs, including in the areas of governance and NBU independence. In view of the difficulties in macroeconomic management, the authorities will need to continue adapting policies to fast changing circumstances, particularly under a severe downside scenario where further consideration of options will be needed, including on mobilizing additional domestic financing to complement donor support. While the authorities are fully committed to the program and adapting policies in response to shocks, the

materialization of large shocks could preclude fully meeting program targets as originally envisaged.

Large and predictable external financial support will be critical for the success of the strategy. Staff analysis suggests that external fiscal financing needs would be at least US$39.5 billion in a central scenario and could reach up to US$57 billion in a downside scenario, given that the authorities may not be able to adopt comprehensive measures to fully offset large shocks. Frontloaded disbursements would help address strains in early 2023.

Strong implementation of the PMB would help pave the way towards a possible future upper credit tranche quality arrangement. The PMB focuses on a targeted set of policy actions to support macroeconomic and financial stability, monitored by parsimonious conditionality:

- ***Fiscal policy.*** Nine months after the start of the war, the authorities' fiscal program aims to ensure adequate spending on core functions, while maintaining macroeconomic stability and initiating fiscal reform measures. The authorities have incorporated 0.6 percent of GDP in revenue measures in the 2023 budget and have committed to further measures to rebuild revenues, including by revoking tax measures introduced under Martial Law. To strengthen budget execution, they will prepare an action plan to prevent and clear arrears and will develop a concept note to strengthen social safety net while safeguarding fiscal sustainability.

- ***Domestic financing and monetary policy.*** Strengthening government debt rollover rates is both desirable and feasible. It will require stronger efforts to tap ample liquidity in the domestic market and would better support the authorities' objective of eliminating reliance on monetary financing in 2023. To help manage liquidity and create incentives for government bond purchases, the NBU plans to increase reserve requirements, and allow banks to fulfill them in part through government bond holdings.

- ***Financial sector.*** The authorities need to start preparing to unwind emergency measures with the aim of gradually re-aligning banking sector norms with international standards as conditions allow. To advance this work, they have committed to prepare a financial sector strategy, and in the near term finalize a terms of reference on one aspect of the strategy, namely bank diagnostics.

- ***Transparency and governance.*** The PMB includes data reporting requirements. Progress on the Ministry of Finance's authority to collect data is essential to improve monitoring and prepare for future engagement with the Fund. Finally, the PMB incorporates commitments to strengthen the governance of state-owned enterprises and banks, finalize appointments at independent anti-corruption institutions, and preserve NBU independence.

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

Discussions were held remotely from Washington DC during November 11–22, 2022, with Finance Minister Serhii Marchenko, National Bank of Ukraine Governor Andriy Pyshnyy and other senior government officials. The staff team comprised Gavin Gray (head), Jean Guillaume Poulain, Armine Khachatryan, Sanaa Nadeem (all EUR); Toomas Orav (SPR); Dermot Monaghan (MCM); Hoda Selim (FAD), Jonathan Pampolina and Ender Emre (both LEG); and Vahram Stepanyan, Ihor Shpak and Maria Sydorovych (Resident Representative office). Stéphane Couderc and Tjoervi Olafsson (both MCM) participated in some technical meetings. Vladyslav Rashkovan (OED) participated in policy discussions. Chasta Piatakovas and Luis Herrera Prada (both EUR) provided support from headquarters.

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CONTEXT

1. **The war is still raging, and security risks remain exceedingly high.** Civilian casualties are mounting, and over a third of the population has been displaced. Active combat remains intense, albeit concentrated in eastern and southern Ukraine. In September, Russia announced the annexation of four regions in Ukraine, which was condemned by the UN Secretary General as a violation of the UN charter and international law. Since October 10, deadly waves of missile and drone attacks, which are assessed to have impacted 40 percent of the power grid as well as other critical civilian infrastructure, have presaged a new phase of the war.

2. **The main macroeconomic policy challenge facing the authorities is to ensure adequate resources for core functions of the state, above all defense, while maintaining stability.** To do so, they have already started normalizing some policies by reversing measures taken at the start of the war and they are seeking large external financing commitments from donors to close financing gaps. However, risks around the central scenario are exceedingly large, and they are also preparing for downside scenarios if the war further intensifies.

3. **Against a backdrop of very large balance of payments (BOP) needs, the PMB aims to anchor stabilization policies and catalyze further donor support.** To help test the authorities' ability to implement policies in the current exceptionally difficult circumstances, the PMB features a parsimonious set of policies and reforms, monitored through structural benchmarks and quantitative targets, coupled with commitments for timely data provision. The authorities are focusing on the most critical macroeconomic policies and a limited set of structural reforms that have a direct bearing on stability, and the PMB embeds these measures in a coherent framework. The PMB is also expected to support ongoing efforts to strengthen donor coordination and improve transparency in commitments and disbursements of aid flows. A successful PMB would help pave the way towards a possible future upper credit tranche (UCT) arrangement likely to involve a more expansive reform agenda over time.

RECENT DEVELOPMENTS

4. **Russia's invasion of Ukraine continues to severely impact people's lives and physical infrastructure.** Besides the large loss of life, the war is having a major social impact (see Box 1). The Kyiv School of Economics estimated the direct physical damage to infrastructure at US$127 billion as of September, over 60 percent of pre-war GDP, predominantly to residential buildings and roads. The impact on the productive capacity of key sectors, due to damage or occupation, is substantial and likely long lasting, e.g., around half of production capacity in metals, an important export sector before the war, has been destroyed (Figure 1). The damage to road and rail networks as well as loss of air and seaport access and capacity have upended logistical networks across the country.

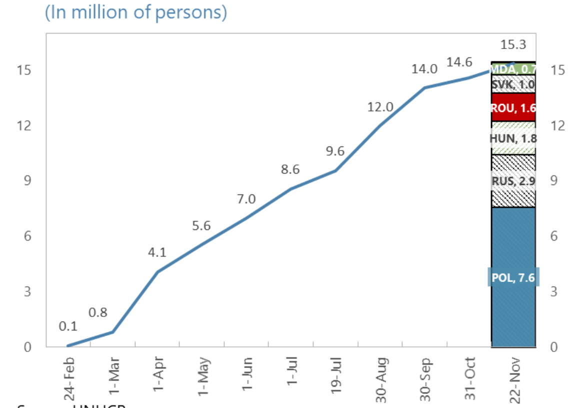
Box 1. Social Impact of the War

In addition to severely hampering economic activity, Russia's invasion of Ukraine continues to have an enormous social impact on the country. With the war still raging, it is hard to get a complete picture of the social consequences, but with thousands of killed and disabled people, and with millions of migrants, internally displaced persons (IDP), and unemployed, it is already clear that the social impact has been devastating.

Civilian casualties. The scale and intensity of the war have caused tremendous human suffering in Ukraine. According to the Human Rights Monitoring Mission in Ukraine (HRMMU), as of October 23, 2022, the number of verified civilian casualties in Ukraine reached at least 16,150 (6,370 civilians killed and nearly 9,780 injured). HRMMU believes the actual figures are much higher, as the information flow from some locations has been delayed, and many reports are pending corroboration (UN OHCHR, October 2022). In October, an Independent International Commission of Inquiry on Ukraine established by the United Nations Human Rights Council determined that war crimes had been committed.

Migration and IDPs. The nine months of war have caused massive population displacement, on a scale not seen since World War II. As of October 2022, the number of Ukrainian refugees recorded in Europe was 7.8 million, and the number of IDPs was 6.5 million (UN OCHA, November 2022). Large outward migration (mainly of highly skilled women) has also negatively affected the labor force. Over half of all Ukrainian children have been forced to leave their homes. An escalation in attacks on energy, water, transportation, and other critical infrastructure, could spur another wave of outward migration and internal displacement.

Total Ukranian Refugees Flow
(In million of persons)



Source: UNHCR

Unemployment. The ILO estimates job losses could reach 2.4 million in 2022, corresponding to a 15.5 percentage point decline in total employment; official unemployment data are currently unavailable.

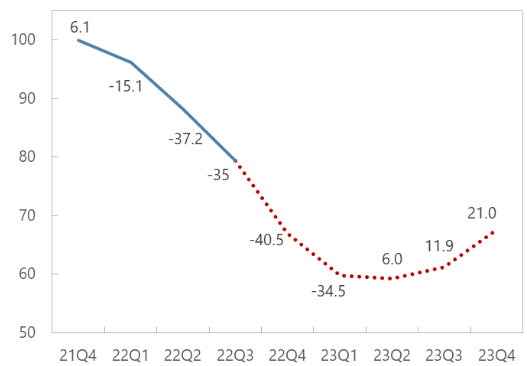
Loss of access to basic needs. The war in Ukraine has caused massive destruction, especially in larger cities, damaging or destroying thousands of homes across the country and leaving millions of people without access to basic needs: up to 16 million people (37 percent of the pre-war population) in Ukraine need water, sanitation, and hygiene assistance; some 14.5 million people (a third of the population) are estimated to need health assistance; over 11.2 million people (a quarter of the population) are in need of emergency shelter or vital household items; and 9.3 million people (21 percent of the population) require food and livelihood assistance (UN OCHA, November 2022). Recent attacks on Ukraine's critical energy infrastructure are further threatening the population's access to electricity, heating, water, and sewage as the winter sets in.

Poverty impact. The World Bank assesses that the war will have a massive impact on poverty. Under its baseline scenario, the population share with income below the national poverty line may more than triple reaching nearly 60 percent in 2022. Based on the global threshold of US$6.85 a day (2017PPP), the World Bank projects that the poverty in Ukraine will increase from 5.5 percent in 2021 to 25 percent in 2022, with major downside risks if the war and energy security situations worsen (The World Bank, October 2022).

5. **Economic activity stabilized over the summer as active combat became more localized in the East, although the recent damage to energy infrastructure is a mounting concern.** With 80 percent of the economy outside of active combat zones, real GDP continued to tick up on a sequential basis, with a decline of 35 percent y/y estimated for 2022Q3. Third-quarter activity was

buttressed by the Black Sea Grain Initiative (BSGI),[1] and the return of nearly 4 million migrants, while survey data showed firms adapting to the war environment, with the share of firms that had stopped working falling from 75 percent in March to 11 percent by September. However, in September, slowing harvests due to poor weather, continuing logistical and working capital constraints, and security developments (including disruptions around the Zaporizhzhia nuclear power plant) weighed on activity. The strikes that began in October are assessed to have damaged over 40 percent of the country's power grid, which will depress the outlook for 2022Q4 and 2023Q1. Thus, real output is projected to contract by 40.5 percent y/y in 2022Q4, bringing the contraction for 2022 as a whole to 33 percent.

Real GDP
(2021Q4 = 100. Labels show y/y growth in percent)

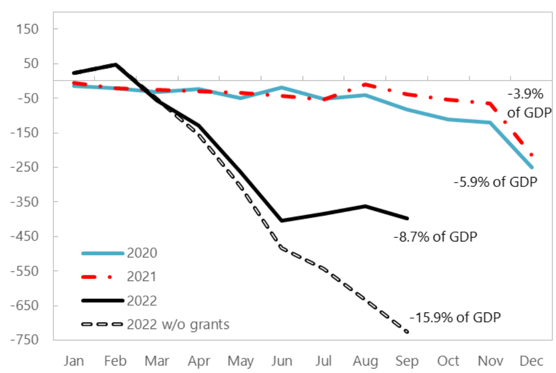


Sources: State Statistics Service of Ukraine; and IMF staff projections.

6. Inflation also continues to rise, largely due to supply bottlenecks. Consumer prices rose 2.5 percent m/m, bringing headline inflation to 26.6 percent y/y in October (with core inflation at 1.9 percent m/m and reaching 21.5 percent y/y). This reflects supply bottlenecks due to the war and the residual effects of the July hryvnia devaluation, offsetting weak domestic demand and wage growth. One-year ahead inflation expectations have stabilized at elevated levels (see ¶9).

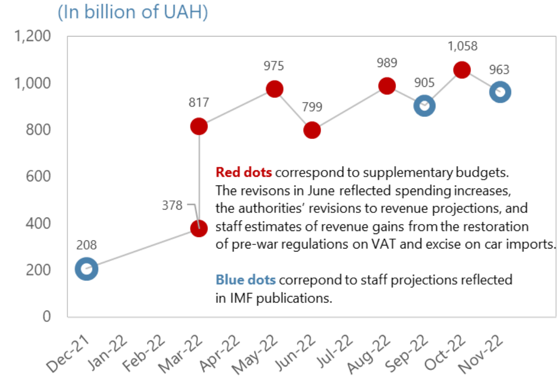
7. Public finances remain under extreme pressure. The cumulative fiscal deficit excluding grants ballooned to 15.9 percent of GDP in September, whereas the overall fiscal deficit was lower, at about 8.7 percent of GDP, on account of substantial external grants. For 2022 as a whole:

Fiscal Balance Cumulative
(In UAH billions)



Source: MoF, IMF staff estimates.

Projections for full-year General Gov. Deficit (2022)
(In billion of UAH)



Source: Ukraine authorities and IMF staff estimations.

[1] The BSGI is an agreement between the Russian Federation, Turkey, Ukraine, and the UN for the safe transportation of grain, related foodstuffs, and fertilizer, including ammonia, from designated Ukrainian ports to global markets.

- Expenditures are projected to be about 52 percent higher in nominal terms than the initial (pre-war) 2022 budget. The government increased spending on defense and social protection through nine supplementary budgets over the course of 2022, initially by compressing non-priority expenditures and later by allowing a higher deficit. In October, a financing gap reemerged after the latest supplementary budget (see ¶19).

- Tax revenues are projected to almost reach pre-war budget 2022 revenues in nominal terms. Personal income tax (PIT) and social security contributions (SSC) receipts have been buoyant, reflecting sizeable wage increases in the defense and security sectors as well as inflation. Corporate Profit Tax (CPT) receipts, which reflect profits in the previous quarter, suffered as the war progressed. Receipts for VAT and excises also suffered sharp shortfalls due to the collapse in economic activity, migration, as well as Martial Law measures (including changes in tax policy rates and administrative arrangements).

Text Table. Fiscal Outcomes and Projections, 2021–22
(In UAH billions, unless otherwise noted)

	2021 Actual	**2022** Pre-war budget	**2022** Current Estimate	**Difference** 2022 Current Estimate vs. pre-war budget (in percent)
Total revenues	**1983**	**2138**	**2606**	**22**
Tax revenues, o/w	1817	1980	1803	-9
Tax on income	514	586	549	-6
Tax on goods and services	731	781	608	-22
Non-tax, o/w	166	159	803	406
Foreign Grants	1	1	462	
Total Expenditure	**2198**	**2345**	**3569**	**52**
Current Expenditure, o/w	1987	2100	3472	65
Compensation of employees	507	563	1286	128
Goods and Services	483	496	887	79
Social Spending	724	759	953	26
Capex and other	212	245	97	-60

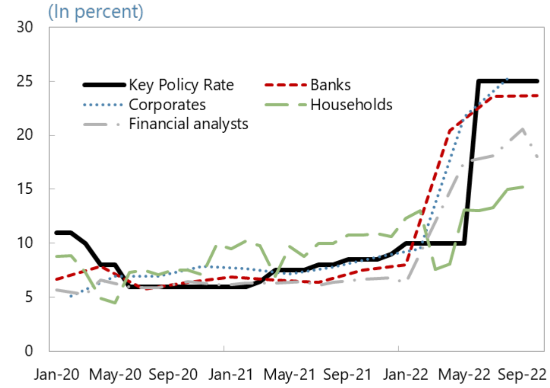
8. **The fiscal deficit has been financed mainly by external and monetary financing.** Through end-October, external budget support loans totaled US$12.6 billion (8.7 percent of 2022 GDP), budget support grants amounted to about US$10.5 (7.3 percent of 2022 GDP) while monetary financing reached US$10.8 billon (7.2 percent of GDP).[2] External support was initially slow to arrive, necessitating monetary financing of US$3.6 billion in June alone, but as support picked up the pace of monetary financing declined in 2022Q3, within the notional monthly ceiling of UAH 30 billion agreed between the National Bank of Ukraine (NBU) and Ministry of Finance (MoF). At the same time, net financing from domestic commercial banks has been negative since the beginning of the

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

war despite ample liquidity. This is in part because yields at government auctions, though slowly rising through the year, have not kept pace with inflation and the increase in the NBU's key policy rate (KPR), and remain very negative in real terms (see ¶32).

9. The NBU has tightened monetary policy to help safeguard price and external stability and suspended its unsecured refinancing facility amid buoyant liquidity conditions. In October, the NBU kept its KPR at 25 percent given inflation developments and elevated expectations, but also in view of the weak economic outlook and incomplete transmission of the 1,500 bps KPR hike in June. This implies *ex ante* real rates, in view of different agents' inflation expectations in a 1-8 percent range as of September 2022. Amid high liquidity, on November 5, the NBU suspended the unsecured refinancing facility introduced following the start of the war.[3] Meanwhile, base money growth remained weak, at 12.2 percent y/y as of end-October, as the NBU has so far sterilized monetary financing with FX sales and NBU certificates of deposits (CDs); accordingly, staff assess that the monetary financing of the fiscal deficit has not yet had a direct material impact on inflation.

Key Policy Rate and 12M Ahead Inflation Expectations
(In percent)



Source: NBU, GfK Ukraine, Info Sapiens.

10. The trade deficit is large and growing. Following an initial shock that suppressed economic activity, imports recovered faster than exports. After a sharp drop, demand returned for essential imports such as food, fuel and material for critical repairs driving total imports to around three-quarters of pre-war levels. At the same time, exports have been constrained by logistical bottlenecks arising from port closures and the destruction of productive capacity across key export sectors, leading to a trade deficit of US$9 billion for January-September. The services balance has also shifted to a deficit due to bank account withdrawals by migrants abroad. However, the income balances have been supported by sizable grants and humanitarian support, resulting in a current account surplus of US$8.5 billion for January–September.

11. Pressures in the FX market eased after the devaluation in July, and reserves remain broadly adequate. Weekly NBU net sales of FX had declined to about US$300 million in August, compared to the highs of US$0.9–1 billion prior to the July devaluation. They rebounded in late September to US$800 million due to slow external inflows, seasonal agriculture-related import demand, a shortage of physical FX cash, and precautionary demand for FX following Russia's mobilization announcement. FX pressures also led to a widening of the gap between the official

[3] Committed refinancing amounts declined from a peak of UAH 161 billion in March to UAH 54.2 billion by end-October (at which point only UAH 26.1 million of the unsecured facility was still outstanding); the low uptake and early repayment of refinancing facilities also reflect the increased cost of refinancing after the KPR hike in June.

exchange rate and cash market rate[4] to 17 percent. Measures to further control P2P payments, fresh external inflows, as well as moderating demand for FX helped bring the gap back to 10 percent, and the pace of NBU net FX sales had eased (to US$200 million) by mid-November. Gross reserves stood at US$24.7 billion as of November 15 (down from US$30.9 billion at end-2021), about 3 months of imports, or 80 percent of the Fund's ARA metric.

12. While the banking system remains operational and liquid, asset quality has deteriorated, and high uncertainty makes a precise assessment of the latter difficult. As of end-October, 89 percent of bank branches remained operational, online banking services were fully available, and the non-cash payment system was functioning in non-combat areas. Liquidity Coverage Ratio and High-Quality Liquid Assets remain high for most banks, enabling them to repay refinancing loans early (see ¶9). However, the official non-performing loans (NPL) ratio as of end-May was 16.5 percent[5] with banks granting payment holidays on retail and corporate loans until the end of Martial Law. The banking sector recorded UAH33 billions 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.[6]

OUTLOOK AND RISKS

13. Staff's central scenario assumes a stabilization of activity in 2023 after a difficult winter, as the economy adjusts to the protracted war. Assuming no large-scale intensification of the war (i.e., active combat contained to the present areas) as well as the continued operation of the BSGI, real GDP growth is expected at 1 percent in 2023. This forecast reflects the expected effects on economic activity in 2023Q1 of a weak harvest (mainly due to disruptions of agricultural activity in occupied and combat-affected areas and the availability of inputs) and subdued consumer sentiment and assumes that the authorities can continue to repair the damage from attacks to the energy infrastructure. After a weak first quarter, growth is expected to strengthen gradually over the course of 2023, reflecting base effects from the very large decline in 2022, continued government defense spending, and some uptick in private activity, including for repair and rehabilitation. A gradual improvement in activity and stabilization in the security situation could lead to small net migration inflows by end-2023. Inflation is expected to remain elevated at 25 percent for the year, mainly on account of logistical constraints.

14. However, a wide range of economic outcomes are plausible, and risks are heavily tilted to the downside (see Box 2 and Annex I). The critical issue remains the scale, intensity, and

[4] The cash rate refers to rates available at the legal but unofficial FX exchanges (i.e., the rate available outside of banks' cash desks).

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

[6] Broad money growth reached 19.8 percent y/y as of end-October, supported by deposit growth amid withdrawal restrictions, while credit growth slowed to 1.8 percent y/y (-19.6 percent in real terms) reflecting slowing credit demand and rising credit risks.

duration of the war, and its impact on the functioning of the economy, including through effects on labor supply and human capital (through population displacement), physical infrastructure, purchasing power, and poverty. A further escalation by Russia, involving more damage to critical infrastructure, particularly energy, water, and transportation, could magnify fiscal and BOP needs through increased imports, weigh on sentiment, and accelerate outward migration. Damage to infrastructure, logistics bottlenecks and high input prices also pose risks to inflation. A broader escalation could also put upward pressure on global energy prices in the winter season and threaten the BSGI, although the downside impact of the latter is a more medium-term risk, impacting future sowing and harvesting decisions with implications for FX inflows in 2024 and beyond. The absence of sufficiently large and timely external financing disbursements could compel the authorities to resort to excessive monetary financing, undermining price, and external stability, putting pressure on inflation and the FX market. Finally, tighter and more volatile global financial conditions amid recession risks in key donor countries could dampen external support.

15. Staff and the authorities recognize that the outlook hinges on key underlying assumptions, amid exceptional uncertainty. If the disruptions caused by the attacks on critical energy infrastructure are quickly resolved and the security situation improves sooner than expected, the recovery in economic activity could be stronger, yielding real GDP growth in 2023 of about 3-4 percent or potentially even higher (see Box 2). With different assumptions around the security situation, port access, and net migration, several outcomes are plausible. The authorities agree that risks to the outlook result in a wide range for estimated external financing needs for 2023 (MEFP ¶8).

Box 2. Ukraine: Macroeconomic Scenarios and External Financing Needs for 2023

Uncertainty around the outlook is extremely high. Whereas the Staff Report mainly discusses staff's central scenario, a large number of outcomes are plausible, depending on how key assumptions underpinning the forecast—such as the duration and intensity of the war, access to seaports and the envelope of external financing—evolve. In addition to the central scenario, this box presents two illustrative alternative macroeconomic scenarios to highlight the impact of such uncertainty on economic outcomes and to develop estimates of external financing needs assuming no monetary financing.

- **Central**. The now more localized war continues through 2023; following a subdued first quarter, activity in noncombat areas continues to adjust to war settings (see ¶13).
- **Downside.** The continuing war has a more negative impact on the economy, e.g., via greater damage to critical infrastructure and industrial capacity and increased outward migration. GDP contracts sharply for the year. On the fiscal side, this generates increased pressure on spending and weaker revenues. On the external side, there is a much slower export recovery and more muted imports. Inflation is higher than in the central scenario due to continuing logistical issues, while continuing FX imbalances drive a larger exchange rate depreciation.
- **Upside.** An improvement in the security situation by mid-year generates a more robust economic recovery, including from accelerated repair, improved sentiment, and the return of migrants. Tax revenues begin to recover by year end, and while spending pressures from defense needs begin to abate, there are increased needs from increased capex and rehabilitation expenditures. Exports increase more quickly than in the central scenario, due to more easing of logistical constraints, though capacity issues take longer to address. Imports increase to support reconstruction related needs, while a recovery in private flows and a decline in migrant withdrawals support the financial account.

Economic outcomes can vary greatly. This table presents key economic indicators for 2023 under each of the three scenarios. Output could vary between 57 and 75 percent of its pre-war value, and the wide band

Box 2. Ukraine: Macroeconomic Scenarios and External Financing Needs for 2023 (concluded)

spending needs in both scenarios but only a slow recovery in the tax and export bases in the upside scenario. On the fiscal front, relative to the central scenario, the overall deficit could widen by nearly 7.7 pp in the downside scenario, and narrow by 1.2 pp in the upside scenario (the limited consolidation reflecting spending needs from accelerated rehabilitation). Similarly, relative to the central scenario, abstracting from differences in official financing assumptions, FX reserves could fall by US$3 billion in the downside scenario and rise by US$1.9 billion in the upside scenario.

Selected Economic Indicators, 2023

	Central	Downside	Upside
Real GDP, growth	1.0	-12.5	10.0
Real GDP, as share of pre-war GDP	68	57	75
Inflation (eop, percent)	22.5	40.0	20.0
Trade balance (US$billion)	-30.4	-30.7	-30.5
Exports (US$billion)	39.7	38.3	42.4
Imports (US$billion)	-70.1	-69.0	-72.9
CA balance (US$ billion)	-5.7	-2.6	-4.7
FX Reserves (US$ billion)	21.0	18.0	22.9
FX Reserves (percent of ARA metric)	62	51	65
Total revenues, share of GDP	47.5	52.0	45.8
Total expenditures, share of GDP	56.5	68.8	53.7
Overall balance, share of GDP	-9.1	-16.8	-7.9
Debt/GDP	89.9	111.4	75.3
External financing needs (US$ billion)	39.5	49.0	38.9

Consequently, external financing needs could rise significantly above those estimated under the central scenario. The central scenario assumes external financing needs of US$39.5 billion in 2023, amid assumptions of no monetary financing and domestic government bond financing consistent with an 80 percent rollover rate. Keeping assumptions around monetary financing and domestic bond financing constant, the scenarios can illustrate the wide range arising around estimates of external financing needs. In the downside scenario, the impact of the worse macroeconomic outlook on revenues and expenditures (including spending for social needs and support to energy companies) would widen the fiscal deficit, leading to an increase in external financing needs by US$9.5 billion, for a total of US$49 billion. By contrast, external financing needs under the upside scenario could amount to US$38.9 billion. In addition, financing requirements relating to the repair and reconstruction of critical infrastructure could further increase these external financing needs (see ¶52).

The range of risks incorporated is not exhaustive. The scenarios do not explicitly model reconstruction or the materialization of additional contingent liabilities from SOEs or the banking system on the fiscal balance sheet.

POLICY DISCUSSIONS

16. **The core objectives of the PMB are to support macroeconomic stabilization, help secure adequate external financing, and prepare the authorities to implement a potential UCT-quality program in 2023.** The key policy objectives are to (i) buttress fiscal and external stability, by enhancing revenue mobilization, containing monetary financing, and therefore reviving domestic debt markets; (ii) contribute to long-term financial stability; and (iii) promote transparency and preserve hard-won gains from past Fund-supported programs, including in the areas of governance, anti-corruption, and NBU independence. The authorities intend to undertake contingency planning (MEFP ¶4) in light of all the risks they face.

A. Fiscal Policy

17. **Ukraine's public finances reflect the brutal realities of the war.** The authorities initially focused on reprioritizing expenditures to accommodate defense and security spending within the

existing spending envelope, given immediate liquidity constraints. However, the devastating realities of the war led to an increase in the spending envelope, and a ballooning of the fiscal deficit despite resilient revenues. So far there have been nine supplementary budgets in 2022.

18. Nine months after the start of the war, the authorities' fiscal program under the PMB aims to ensure adequate spending on core functions, above all defense, while maintaining macroeconomic stability and initiating fiscal reform measures. On the spending side, the criticality of defense and security spending has meant that traditional goals such as growth-enhancing capital spending or enhancing the social safety net have become elusive. Overall, the conduct of fiscal policy will continue to require a delicate balance between different priorities within a binding financing constraint.

Fiscal Policy for the Remaining of 2022

19. The authorities are taking urgent steps to close a general government financing gap that has emerged in the last few months of 2022. A supplementary budget approved by Parliament on October 18 increased spending by UAH 387 billion (MEFP ¶11), mostly current expenditure (including accrued wages of UAH 233 billion). The authorities have already identified some measures to help close the resulting financing gap:

- *Above the line*. Expenditure items have been identified, primarily in goods and services, that can be under-executed by postponing underlying contracts, totaling UAH145 billion (3.1 percent of GDP), while VAT refund claims are likely to be lower than previously estimated due to the impact of war on export sectors, increasing the net VAT by UAH 16 billion (0.3 percent of GDP).

- *Borrowing/liquidity*. The authorities also plan to raise UAH 13 billion (0.3 percent of GDP) through additional domestic borrowing and will draw resources from the Treasury Single Account as well as liquidity in local accounts, together amounting to about UAH 120 billion (2.6 percent of GDP).

20. After these measures, the residual general government financing gap is assessed at UAH 67 billion (1.4 percent of GDP). [7] Unless further financing can be identified before the end of the year, this could result in the accumulation of arrears, with carryover implications for 2023 and beyond. Confirmation of the full picture of arrears is complicated by the limitations under Martial Law on the MoF's (Treasury's) authority to collect data from all spending units in general government. The authorities are committed to restore the MoF's authority to collect data, and to strengthen its ability to obtain data on arrears (MEFP ¶12) and monitor the financing gap—whose size is subject to considerable uncertainty. Progress on this front is essential to improve monitoring

[7] Based on the October supplementary budget, the underlying financing gap was estimated at around UAH 346.7 billion. In addition to the measures mentioned in paragraph 19, revised assumptions on project financing and amortization payments have also contributed to the decline in the residual financing gap.

and prepare for future engagement with the Fund. The authorities will re-assess in mid-December the likelihood of arrears emerging, and potential implications for subsequent years.

Fiscal Policy in 2023

21. The 2023 budget adopted by Parliament in November reflects difficult political decisions in reconciling the priorities of the war economy with binding financing constraints. The overall spending envelope was determined by projected domestic revenues, assumptions for available domestic bond market financing, and assumptions on external financing. While, in staff's view, the revenue projections are prudent and reflect the realities of war, the spending envelope is subject to sizeable risks.

22. Despite tight control of non-priority spending, the 2023 budget targets a deficit (excluding grants) of about UAH 1.3 trillion (21.4 percent of GDP):

- Tax revenues are projected to decline by about 6 percentage points of GDP even after measures on fuel (restoring pre-war rates for excise and VAT from July 2023, 0.6 percent of GDP), reflecting the impact of the slow recovery of domestic demand on VAT, the lagged impact of the fall in corporate profits on the CPT, the weakening of personal income tax due to the decline in wages, and the narrowing of the tax base on account of relief measures.

- Current expenditures are assumed to decline by an enormous 22 percentage points of GDP, reflecting difficult political choices and the high degree of uncertainty around the central scenario. In particular, the public sector wage bill is set at about UAH 943 billion (16.7 percent of GDP), a 27 percent nominal reduction relative to 2022, to be operationalized through tight spending limits for line ministries and other spending units. Social benefits have been capped, and only pensions are being indexed according to the existing indexation rule.[8]

23. The authorities have also established a special fund within the state budget to channel external financial resources (if and when available) for the immediate repair and reconstruction of critical infrastructure. The authorities have indicated that spending under this special fund could reach US$17 billion (about 10 percent of GDP),[9] although staff judge that absorption capacity is likely to limit such expenditure to a maximum of US$8 billion this year. At this juncture, the spending from the special fund is limited to 50 percent of NBU's profit transfer for 2023 that the authorities have decided to earmark as source of funding, preliminarily estimated at

[8] According to the current pension indexation framework, 95 percent of pensioners receive indexed pensions, whereas 5 percent receive non-indexed pensions. The formula for indexation includes 50 percent of average wage growth of the last 3 years (t-2, t-1 and t) and 50 percent of inflation (t year). The pension benefits indexation applies from March 1st of the year under discussion. There is also a category of pensioners that receive professional and seniority top ups.

[9] In September, Prime Minister of Ukraine Denys Shmyhal identified needs of US$17 billion on the basis of the World Bank's Damage Needs Assessment ([Ukraine Recovery and Reconstruction Needs Estimated $349 Billion (worldbank.org)](#))

UAH 35 billion (0.6 percent of GDP). The governance of the fund will be subject to the transparency and accountability policies and practices pertinent to special funds under the state budget (see ¶30).

24. The risks to expenditure in the 2023 budget are large, with a high likelihood of materialization of key spending pressures:

- ***Arrears***. As noted above (¶20), arrears may emerge in 2022 with carryover effects for 2023 and beyond. Under the central scenario, staff assumes additional spending in the amount of about 0.5 percent of GDP for arrears clearance in 2023, although this assumption is subject to risks.

- ***Energy sector***. Additional expenditures will likely be needed to support the energy sector (see Box 3).

- ***Social assistance***. Social strains may lead to additional spending needs, including to support internally displaced people (IDPs) or other emerging vulnerable categories (e.g., war veterans). For instance, assuming no changes in the current social assistance framework, partial indexation of social assistance beyond the minimum subsistence level would cost 2.2 percent of GDP.

- **Risks arising from contingent liabilities.** As the war continues, the risks from contingent liabilities, including PPPs, guarantees, SOEs, and banks, will continue to grow. The authorities are committed to strengthening the link between fiscal risks assessment and their impact on spending categories, including monitoring and assessment of risks from government guarantees.

25. In light of these risks, the authorities are also determined to start taking measures to mobilize additional revenues. This forms part of a strategy to restore a taxpaying culture and avoid unduly narrowing the tax base. Specifically:

- In the very near-term, the authorities are committed to submitting three draft laws to Parliament (***Structural Benchmark***, end-January 2023, MEFP ¶15) on: (i) cancelling the moratoria on tax audits (effective July 1, 2023); (ii) removing idiosyncrasies of the application of the simplified tax regime by taxpayers under the single tax of 2 percent, on restoring pre-war regime for taxpayers, who became eligible for the 2 percent simplified tax regime in the context of Martial law, effective 1 July, 2023 (the estimated revenue gains from this measure is assessed at about 0.13 percent of GDP for 2023); and (iii) ensuring full-scale enforcement of the usage of cash registers in retail outlets (and associated settlement and payment infrastructure), including restoring liability for violations (effective July 1, 2023).

- The authorities will also implement the automatic exchange of information for taxation purposes (Common Reporting Standard (CRS))[10], which should strengthen efforts to combat tax evasion especially of a cross-border nature. Legislation is under preparation.

[10] See Common Reporting Standard (CRS) - Organization for Economic Co-operation and Development (oecd.org)

- With the help of Technical Assistance from the IMF, the authorities are working on the development of an integrated roadmap of tax policy and administration measures, including restoring in the short-term tax administration and policies to their pre-war setup.

- Looking further ahead, the authorities plan to work on the broader design of tax policies and measures for building a modernized revenue administration (including limiting the possibility of PIT evasion through the use of the simplified tax regime by group 3 taxpayers).[11] Such measures should help build tax policies and form a tax base consistent with post-war fiscal policy goals.

Fiscal Structural Reforms

26. Managing fiscal risks in 2023 and beyond requires the authorities to implement a wide range of measures to ringfence risks and manage incipient spending pressures. Examples include rethinking aspects of social assistance, regaining full control over budget processes, and continuously strengthening public financial management.

27. In view of the risk of spending pressures arising from the need to provide social assistance to vulnerable groups, the authorities intend to start work on a plan for post-war social assistance that reconciles these needs with fiscal sustainability. New vulnerable groups (e.g., IDPs, war veterans) have emerged since the start of the war, and while their needs are currently being met within the existing framework, a more thorough review of post-war social assistance, including for such groups, is warranted. Fiscal sustainability considerations should be a core pillar of the design of post-war social assistance reform. As a first step, the authorities will prepare a concept note ***(Structural Benchmark***, end-January 2023; MEFP ¶17) laying out the broad contours of their strategy to approach reforms of the social safety net. The ultimate aim would be to achieve targeted, adequate, and efficiently delivered social assistance to the population, including the needs of the new groups. Technical assistance from the Fund's Fiscal Affairs Department is expected to support the preparation of this concept note, and the authorities are also seeking World Bank advice on lessons from post-conflict countries, and on the specificities of post-war social assistance frameworks.

28. Mitigation of fiscal risks arising from war-time weaknesses in budget processes and payment discipline require swift implementation of measures to regain and strengthen control over budget processes, that would also help alleviate spending pressures on 2023 budget. Key steps under the PMB include:

- *Enhancing payment discipline*. The authorities will take measures to enhance payment discipline, which should allow to take better control over the operations of spending units, avoid delays in payments and arrears accumulation and prepare for steps to reduce the existing stock.

[11] Group 3 refers to taxpayers with annual income up to UAH 7 million pre-war. Taxpayers in this group can either opt for a simple tax of 5 percent (for taxpayers choosing not to pay VAT) or 3 percent (for taxpayers who choose to pay VAT).

Specifically, in the short-term they will develop an action plan to prevent and clear arrears during the 2023 Budget and beyond (Structural Benchmark, end-January 2023, MEFP ¶12).

- In the near-term, authorities will also initiate legislative amendments to restore the MoF (Treasury's) authority to collect information essential for certain categories of financial reporting. This will help establish oversight over budget arrears at both the state and local level, as well as Social Security Funds, to have a clear view of the stock of arrears on a monthly basis, with a clear monitoring mechanism aimed at preventing the accumulation of new arrears.

- While mindful of Martial Law, the authorities are committed to take measures to settle the existing stock of such obligations in accordance with the requirements of budget legislation in a structured and transparent manner.

- *Data reporting*. The authorities are committed to maximum transparency in data provision possible under Martial Law, covering all expenditures and arrears, which is vital for efficient treasury cash management and liquidity forecasting. To improve the predictability of available liquidity and lower risks of sudden financing pressures, the MoF will continue to improve cash forecasting and liquidity management in line with the PFM Reform Strategy for 2022–25.[12] This would involve enhancing the exchange of information with key budget spending units, and the introduction of analytical IT tools.

29. The authorities are also committed to resuming efforts to strengthen public financial management (MEFP ¶20), which will help them monitor and address the fiscal risks highlighted above. Specifically:

- With the help of IMF Technical Assistance, the authorities will seek to apply fiscal risk analysis to inform their understanding and formulation of macro fiscal aggregates and wider fiscal management. Going forward, the authorities are preparing to improve the predictability and credibility of the fiscal projections to better support budget preparation and reduce deviations during the budget execution phase.

- The authorities will develop upside and downside scenarios around central projections of tax revenues to improve the realism of their projections and have a better understanding of risks to the central scenario.

- The authorities are also determined to deepen their analysis of the relationship between fiscal risks and specific spending categories, including social funds, as well as contingent liabilities (especially from Public Private Partnerships, guarantees and SOEs). Work to enhance institutional capacity and the monitoring and assessment of fiscal risks from government guarantees will continue.

[12] See Ukraine's PFM strategy.

30. An important part of public finance and investment management is the planning and execution of the special fund for the repair and reconstruction of damaged infrastructure. In line with the authorities' experience of managing other special funds in the state budget, the MOF will ensure sound governance and transparency in the use of this fund's resources by: (i) preparing clear and transparent selection criteria and procedures for priority spending to be approved by the Cabinet of Ministers of Ukraine (CMU); (ii) including underlying amounts in budget documentation and fiscal reports; (iii) including cash resources in the Treasury Single Account; (iv) establishing safeguards on the use of funds and reporting on them; and (v) conducting and publishing audits.

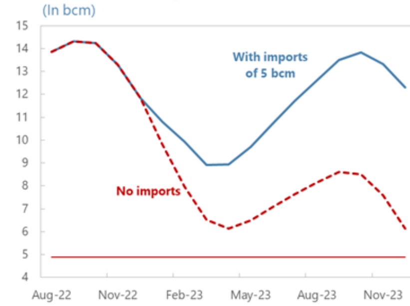
Box 3. Ukraine: Spending Pressures in the Energy Sector

Ukraine faces a number of expenditure risks at the current juncture, especially from the energy sector.

- *Electricity Infrastructure*. The strikes since October 10 have damaged around 40 percent of Ukraine's electricity infrastructure, impacting energy distribution and power generation. Repairing key plants and substations represent a critical spending priority. To date, the cost has been largely borne by Ukrenergo (the electricity Transmission System Operator (TSO)). The National Energy and Utilities Regulatory Commission (NEURC) is currently considering an increase in the TSO tariff of about 50 percent, which would provide additional resources to Ukrenergo.[1/] If further resources are needed for urgent repairs, the authorities have committed to ensure adequate financial support (MEFP ¶18).

- *Gas sector*. Under normal weather conditions, and assuming consumption and domestic production continue to follow trends that have prevailed since the beginning of the war, Ukraine would have moderate needs for gas imports this winter season for heating and industrial purposes. However, disruptions to the usual sources of power generation are increasing the need for gas in the energy mix by about 2 to 3 billion cubic meters (bcm). Accordingly, staff's central scenario assumes that gas purchases of 5 bcm will be needed in 2023, evenly spread over 12 months. To help address Naftogaz's associated increase in financing needs, the government is already providing budget support to the company through an implicit subsidy in the form of foregone gas royalty revenues, estimated around UAH145 billion (US$3.5 billion) for 2023. More support will likely be needed, including as compensation for public service obligations.[2/] At the same time, District Heating Companies (DHCs) and the Gas Transmission System Operator (GTSO), whose liquidity position is suffering from a drop in transit fees and low-capacity use, may also require support. Overall, staff estimate that up to UAH150 billion (US$3.6 billion) in additional financial support to Naftogaz, the GTSO, and DHCs could be required in 2023.

Ukraine's Gas Storage
(In bcm)



Source: IMF staff estimates

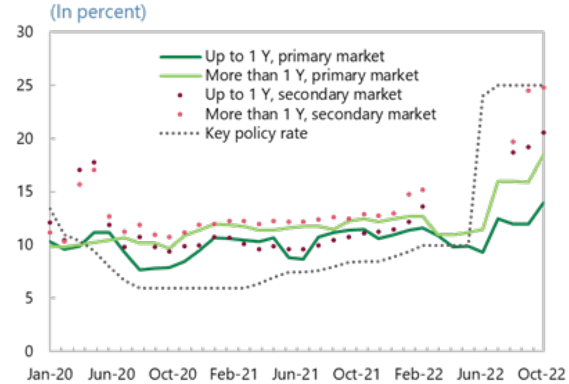
1/ This would not impact household customers, for whom the tariff is fixed under public service obligations.
2/ Retail gas prices are fixed at a level of UAH 7.4 per cubic meter, significantly below import parity prices.

B. Domestic Financing

31. An important policy objective under the PMB is to shift toward a domestic financing mix that better supports macrofinancial stability by eliminating reliance on monetary financing. Together with adequate external financing, this would require increased domestic issuance of government securities, given limited near-term prospects for external market access. With banking system liquidity at an all-time high (UAH 361 billion or US$9.9 billion in NBU CDs as of end-November) and continued prospects of liquidity injection from the large fiscal deficit amid limited demand for credit from the private sector, it is feasible as well as desirable for the government to increase its domestic borrowing.[13]

32. Despite ample liquidity, domestic commercial banks have redeemed government securities in net terms since the start of the war.[14] Staff assesses that this reflects two main factors. First, the rates offered on primary market bonds, now in the 16-19 percent range, remain negative in real terms, and below other relevant interest rates (notably the NBU's KPR). Amid strong deposit growth and low private credit demand, banks have increased their holdings of NBU overnight CDs, which currently offer an interest rate of 23 percent. Consequently, bank rollover rates on government bonds have remained low, reaching 37 percent between July-August in 2022, and rising to 63 percent in October as primary market yields ticked up. Second, individual banks have different liquidity and sovereign credit risk appetites, as well as regulatory capital requirements and internal risk compliance limits, which have affected their demand for government securities; since the war, the majority of bank purchases of government securities has come from state-owned banks.[15]

Government Hryvnia Bond Yields
(In percent)



Sources: NBU.

33. In view of these considerations, the authorities have designed a multi-pronged strategy to improve domestic rollover rates, with the aim of fully covering redemptions in 2023 (MEFP ¶25).

- *First*, the Ministry of Finance plans to adjust yields offered on the primary market to match market demand. This price discovery process would allow the Ministry of Finance to better match instruments offered to the needs of different market segments. In recent months, the Ministry of Finance has increased the yield from 14 percent up to 19.25 percent for some

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[13] An added benefit of reviving the domestic bond market would be enhanced liquidity management, which could reduce the risk of suboptimal financing should downside risks materialize. Frequent auctions would give the authorities flexibility to expand issuance when liquidity is buoyant and build up cash balances for worse times.

[14] Domestic banks comprise state-owned banks, private banks owned by Ukrainian nationals, and foreign-owned subsidiaries.

[15] The investor base for government securities is dominated by domestic commercial banks (about 40 percent of total holdings, the stock reflecting mainly the post-2015–16 recap bonds), with limited participation from domestic institutional investors (such as pension funds or insurance companies, at about 8 percent) and nonresidents (5 percent of the total base). The NBU's large stock of government securities reflects monetary financing in the 2015–16 crisis; monetary financing was subsequently disallowed under NBU Law, although this provision was suspended under Martial Law in February 2022.

issuances.[16] Increasing primary market yields in sufficient amounts is a necessary condition to mobilize bank financing in a transparent and market-based manner.

- *Second*, in conjunction with the measures above, the NBU plans to allow banks to fulfil up to half of their reserve requirements with benchmark government securities, which is expected to generate a one-time increase in demand for government securities in the primary market of about UAH 40 billion (see ¶38 and ¶39).

- *Third*, the NBU and the Ministry of Finance will conduct a bank-by-bank analysis of liquidity conditions, preferences, and compliance requirements, to better understand market demand and which would inform the design of future auctions.

34. This strategy, if well executed, should help support a gradual increase in domestic bond rollover rates, thereby mitigating risks from suboptimal forms of financing. All elements of the strategy should be undertaken together to support an increase in domestic rollover rates through the course of the year. Under the strategy, banks' exposure to sovereign debt as a share of total assets is expected to remain below pre-war levels, limiting near-term risks to the banking sector. The expected increase in interest costs is also assessed to be manageable since yields would likely remain negative in real terms (deflated by contemporaneous inflation). Given urgent financing needs and the risks presented by available alternatives (see ¶35), staff's sees the proposed strategy as both viable and desirable at the current juncture. Nonetheless, the envisaged increase in domestic rollover rates may not materialize, which would likely lead to increased reliance on monetary financing while steps to enhance the strategy are considered. On the other hand, should domestic (or external) financing materialize in higher amounts than expected, this could be partly utilized to build cash buffers given risks to the budget execution and uncertainty around future financing flows. Staff has encouraged the authorities to explore new instruments to achieve these goals.[17]

35. Containing monetary financing would reduce risks to price and external stability. Post-war country experiences reveal a substantial risk of hyperinflation from continued recourse to monetary financing.[18] Accordingly, the PMB establishes an indicative target on monetary financing.[19] For December 2022, the ceiling on monetary financing will be consistent with the planned purchases of war bonds by the NBU of an annual amount of UAH400 billion. Consistent with policy intentions to revive the domestic debt market and thereby eliminate monetary financing, an indicative target

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[16] Primary market data from the November 21 auction reveal banks have bid at higher rates, suggesting some appetite for government bonds should they provide an adequate return for risk. Staff expects that a larger share of these bids at higher yields will be accepted in the future.

[17] Examples could include instruments linked to inflation.

[18] See, for instance, Lopez and Mitchener 2018 on post-World War I outcomes in Austria, Germany, Hungary, and Poland and Petrović and Vujošević 1999 on Yugoslavia.

[19] In sizing the appropriate ceiling for monetary financing, key considerations include keeping money base growth at or below nominal GDP growth; reducing the amount of monetary financing in nominal terms, given the important role this plays in the formation of agent's inflation expectations; and defining a threshold for maximizing seigniorage revenue with minimal inflation tax.

for end-March 2023 is set at zero. In the case of a temporary shortfall in external financing which the authorities cover in the first instance through higher-than-programmed issuance in the local government bond market, the indicative target under the PMB would allow monetary financing of up to UAH 50 billion for 2023Q1.

C. Monetary and Exchange Rate Policy

36. Monetary and exchange rate policies will remain focused on safeguarding price and external stability in the context of war-time fiscal dominance. The very large fiscal deficit and the associated monetary financing have injected significant liquidity into the economy, putting pressures on the exchange rate. The PMB will be underpinned by monetary and exchange rate policies that aim to strengthen the nominal anchor and safeguard FX reserves in a context of extremely high uncertainty. This would involve ensuring that interest rates are set at a level consistent with mobilizing domestic savings to finance the fiscal deficit (thereby eliminating monetary financing in 2023), supporting exchange rate stability, and, in conjunction with capital flow measures, ensuring adequate FX reserves.

37. The major challenge for the NBU is managing liquidity in a context of elevated risks. Significant monetary financing of the fiscal deficit in 2022 has impaired monetary transmission. Deposit and lending rates have not fully adjusted to the KPR hike (Figure 3), reflecting buoyant liquidity in the banking system, especially in state-owned banks. Further, as noted above, the transmission of the KPR to primary market rates has been incomplete. On lending rates, the weak transmission reflects the heightened role of low-interest rate government-supported lending, despite high credit risk.

38. The NBU plans to tighten reserve requirements and allow banks to fulfill up to half of their reserve requirements with government securities (MEFP ¶30). This measure is aimed at absorbing liquidity while stimulating demand in the government securities primary market. Reserve requirements are to be increased by 5 percentage points on hryvnia and FX demand deposits, and banks will also be allowed to meet up to half of reserve requirements with government securities (40 percent of which can comprise existing benchmark securities, and the remainder through newly issued benchmark securities). The measure is expected to translate into around UAH 40 billion of additional primary market demand, assuming banks would fully use the available space for government bonds, as reserve requirements are otherwise unremunerated.

39. The inclusion of government bonds in the reserve requirement has drawbacks, and this feature should be phased out in due course. The measure can reduce the effectiveness of the reserve requirement instrument, weaken monetary transmission, and thereby complicate monetary policy operations. First, the withdrawal of liquidity from an increase in the reserve requirement under this measure will be smaller than a more conventional reserve requirement as, by design, the newly issued government bonds are intended to support additional government spending, which could bring additional injection of liquidity back into the system. Thus, for the purposes of monetary policy implementation and to ensure overall liquidity is adequately contained, it will be important to carefully monitor the liquidity absorbed by the portion of reserve requirements met by traditional reserves. Second, such a measure alters banks' asset and liquidity management patterns, incentivizing them to hold longer-term assets such as government bonds versus more liquid cash, which would make the scheme difficult to phase out. It will thus be important to develop a clear and well-communicated plan to phase out the measure in a manner that avoids disruptions. A third factor is that the measure may distort the yield curve, since not all bonds are eligible to meet reserve requirements, although this is not a critical issue relative to authorities' overriding policy objectives. Finally, the inclusion of government bonds in reserve requirements should be adopted only in conjunction with the envisaged increase in government bond yields on the primary market, to ensure this measure does not impair monetary policy transmission.

40. The NBU should continue to consider other elements of its monetary operations toolkit to manage liquidity. On liquidity absorption, the NBU plans to modify the design of its CDs, reverting to the 14-day maturity at the KPR, as well as to introduce additional longer-term CDs in due course, which should support liquidity management (MEFP ¶30). On liquidity provision, in view of the segmentation of liquidity across banks, the use of repo facilities (for which the infrastructure is in place) should be encouraged to help banks manage liquidity among themselves.

41. The war has led to imbalances in the FX market and necessitated net FX sales by the NBU. The economy's capacity to generate FX through exports has been constrained, while the demand for FX for imports (notably energy and defense) and precautionary savings has increased. This net FX demand has resulted in the NBU consistently selling FX (as of end-November, US$18.5 billion in net sales since February 24), that would have resulted in a drain on reserves absent sizable external financing inflows. Under the assumption that external financing is disbursed in the amount and timing programmed, and absent any unanticipated surges in FX demand, and under the current regime of FX controls, drains on FX reserves levels could be largely contained, thereby supporting the exchange rate peg and an adequate level of FX reserves.

42. The authorities continue to adjust the FX controls to help balance the FX market and support exchange rate stability, while adapting to the needs of the economy. The FX controls have created a spread between the official exchange rate and the cash market exchange rate. This spread influences exchange rate expectations and is affected by imbalances in demand between the official and cash markets. To limit outflows of FX, the NBU tightened withdrawal limits on card payments abroad in July and banned P2P payments from hryvnia payment cards to foreign banks in late September. It has also taken measures to relieve pressures in the FX cash market by allowing individuals to purchase noncash foreign currency for FX or FX-indexed term deposits.[20] The NBU has also undertaken measures to facilitate FX transactions that support humanitarian and defense efforts as well as steps to better support the needs of trading firms amid logistical difficulties, including by

[20] The noncash FX rate, which is available through banks, is set at the official rate ±1 percent. These facilities would thus allow individuals to access FX at a more favorable rate than through the cash FX market to relieve demand pressures on the cash market and, in turn, on the spread between the cash and official exchange rates.

extending settlement deadlines for export and import transactions.[21] In view of the risks, the authorities will continue to monitor carefully key sources of FX leakages, including from card withdrawals abroad, import over-invoicing, and noncash payments for physical or crypto assets, as well as the enforcement of measures. In addition, in view of the uncertain economic outlook through the winter season, it will be important to prepare contingency plans should risks to the FX market materialize.

43. The authorities remain committed to upholding the independence and institutional effectiveness of the NBU. A strong and independent NBU will be critical to achieving macroeconomic stability, and the elimination of monetary financing, as well as abstaining from activities outside the core functions of the NBU, including quasi-fiscal support, will be crucial in this regard (MEFP ¶33 and 34). It will also be important to ensure that the distribution of NBU profits to the state budget takes place in line with established procedures in a transparent manner to preserve NBU independence. In early November, the NBU undertook a reorganization of its structure along functional lines that better aligns it with its legal framework, as recommended by past IMF Technical Assistance, and it will be important that the NBU's governance structure continues to preserve its effective autonomy and institutional capacity. Work on an IMF safeguards assessment of the NBU has started, with a mission envisaged for early 2023.

D. Financial Sector

44. Emergency measures were crucial to maintain the stability of the banking system in the initial stages of the war but are necessarily temporary given the distortions they create and the resulting difficulties in assessing banking sector health. The banking system has been subject to regulatory forbearance on capital, credit, and reporting standards.[22] Although the system is largely operational and liquid, the impact of the war on asset quality is expected to be sizable but difficult to quantify with precision due to these measures.

45. The NBU will update its financial sector strategy to start preparing for the transition away from emergency measures and restore prudential norms. The strategy was last updated in 2021, and so predates the war. The updated strategy update will *inter alia* address: (i) the safe unwinding of exceptional measures; (ii) bank diagnostics, including an asset quality review to independently verify asset values and data quality, solvency stress tests to assess banks' viability, and an assessment of NPL resolution challenges; (iii) developing a framework to address any capital shortfalls; (iv) creating an interagency strategy to tackle high NPLs; and (v) further developing contingency plans to respond to potential additional shocks due to the war and litigation risks over failed banks and constitutional challenges on the Deposit Guarantee Fund and Bank Resolution Laws. As robust bank diagnostics are critical to the success of the overall strategy, the NBU will set

[21] Staff are in the process of assessing these measures to determine whether they constitute exchange restrictions or multiple currency practices subject to Fund approval under Article VIII, Sections 2(a) and 3.

[22] See IMF Country Report No. 2022/323

out the methodology and processes in a technical terms of reference by end-January 2023 in consultation with Fund staff (***Structural benchmark***).

46. The authorities remain committed to strengthening the governance of SOBs. Past reforms of the supervisory boards, including by attracting deep international expertise, has substantially enhanced their independence and effectiveness, and the authorities recognize that upholding the spirit of governance reforms in SOBs is key to preserve financial stability, protect public finances, and maintain the confidence of their international partners (MEFP ¶37–38). A recruitment process to renew the independent supervisory board members of the SOBs has recently been initiated. HR firms have been selected for each bank, and the selection process is expected to be completed in the first quarter of 2023. It is vital that this succession process sustains operational continuity and institutional memory, that the new board members are independent so that the supervisory boards may operate free from political pressure, and that the NBU rigorously applies their fit and proper assessment.

E. Governance, Transparency, and Anti-Corruption

47. Effective transparency and accountability mechanisms and good governance are key to prepare for a potential UCT arrangement as well as help ensure institutions are ready for post-war reconstruction efforts. Taking steps to promote data transparency will be important to assess economic circumstances and risks in the near term, and also to ensure adequate monitoring under a potential UCT arrangement. The Technical Memorandum of Understanding (TMU) therefore incorporates increased requirements for data provision, including with respect to timely information on arrears and government guarantees. Aside from data, other priority areas include advancing PFM reforms ahead of reconstruction and maintaining good corporate governance in state-owned enterprises (SOEs) and banks (see ¶46).

48. The authorities also reiterated their strong commitment to sound corporate governance in SOEs. A new Law on Joint-Stock Companies that was recently approved and will become effective in January 2023 aims at improving Ukraine's corporate governance framework, and a law on corporatization of Energoatom has passed the first reading in the Rada. To strengthen corporate governance in one of the largest SOEs, the authorities have committed to appoint and make fully operational the supervisory board of Naftogaz by end-January 2023, based on transparent and competitive selection procedures **(Structural Benchmark, MEFP ¶39).**

49. Preserving independent anti-corruption institutions helps ensure a level playing field, promotes donor confidence and sets standards that will be critical for post-war reconstruction (MEFP, ¶40). Despite the war, the National Anti-Corruption Bureau of Ukraine (NABU), Specialized Anti-Corruption Prosecutor's Office (SAPO) and the High Anti-Corruption Court (HACC) have continued unabated with their anti-corruption enforcement activities. Appointing and retaining competent and independent senior staff in these institutions (e.g., the appointment of the SAPO head in July and the expected selection of the NABU head by end-March 2023) contribute to the sustainability of anti-corruption efforts and prevent retrenchment of vested interests. Sustaining progress in strengthening independent institutions and preserving key governance reforms from past Fund-supported programs will support the durability and longevity of Ukraine's anti-corruption reform movement.[23]

50. The authorities' commitments to incorporate the highest transparency and accountability standards into their eventual post-war reconstruction strategy are welcome. Key elements will include utilizing digital technologies (including by drawing on experience from the e-procurement ProZorro system), establishing effective mechanisms to address corruption risks, and strengthening auditing capacities. Close coordination with civil society organizations and international partners will also contribute to transparent, inclusive, and robust oversight throughout the life cycle of reconstruction projects and should be integrated as the strategy is developed.[24]

Ukraine. Modalities of Official Support
(US$ billion) 1/

	2022
Loans	18.65
Multilateral direct loans	11.79
European Investment Bank	0.72
European Union	7.28
IMF	2.69
World Bank	1.10
Bilateral direct loans	1.36
Bilateral via IMF Administered Account	1.73
Bilateral via World Bank 2/	2.33
Project loans	1.44
Grants	14.00
Bilateral direct grants	0.95
Bilateral via IMF Administered Account	1.05
Bilateral via World Bank 2/	12.00

Source: Ukrainian authorities and IMF staff estimates.
1/ Based on acutal data as of end October 2022, and projections for November and December.
2/ Includes parallel budget support, loans, guarantees, and grants via World Bank Financing of Recovery from Economic Emergency in Ukraine (FREE) Special Development Policy Loan/Multi-Donor Trust Fund (MDTF) and the Public Expenditures for Administrative Capacity Endurance (PEACE) MDTF.

EXTERNAL FINANCING

51. Sizable external financing in 2022 has been crucial to support Ukraine and preserve macroeconomic and external stability. Staff expects that by the end of the year, US$32.7 billion in budget and balance of payments support will have been disbursed to Ukraine, of which US$14 billion in the form of grants. The two largest contributors were the US (for US$11.5 billion) and the EU (US$7.3 billion).[25] Part of the financial support was channeled via the IMF Administered Account and the World Bank.

52. For 2023, staff analysis suggests that external fiscal financing needs would be at least US$39.5 billion and could reach up to US$57 billion in a downside scenario, reflecting high uncertainty and large spending pressures. Under staff's central scenario,[26] external fiscal financing needs would reach US$39.5 billion. External financing commitments for 2023 are in the process of

[23] On November 16, 2022, amendments to the AML/CFT law were enacted, and staff will monitor its future implementation and impact on anti-corruption efforts, including on the consequences of the relaxation of due diligence requirements for politically exposed persons.

[24] Financial support of $2.2 billion was channeled via the IMF Administered Account for Ukraine as of end-November.

[25] Support from the European Union is provided in the form of an exceptional package of Macro-Financial Assistance (MFA) loans, as endorsed by the European Council. To finance the MFA, the European Commission borrows from capital markets on behalf of the European Union.

[26] The baseline for domestic financing assumes no net monetary financing in 2023 and aggregate rollover rates of 80 percent for domestic bonds.

being approved by key donors, therefore much of the grants and borrowing assumed in the central and downside scenarios are still in the process of being approved.[27] Should additional external financing become available, the authorities have identified around US$17 billion of critical infrastructure needs, of which staff considers about US$8 billion could be absorbed by the country in the current circumstances (see ¶23). In a downside scenario (see Box 2), external financing needs could increase by an additional US$9.5 billion. Thus, aggregate external financing needs could, under the assumptions of such a scenario, reach up to US$57 billion.

External Financing Needs Scenarios, 2023
(in US$ billions)

	Central	Downside
External Fiscal Financing Needs (General Government)	**39.5**	**49.0**
Additional Financing for critical infrastructure 1/	8.0	8.0
Total Potential External Financing Needs	**47.5**	**57.0**

Note: 1/Higher absorptive capacity and availability of financing could push infrastructure needs up to US$17 bn

53. Ukraine's BOP needs in the short and medium term are sizable and subject to significant risks. The large BOP gap mainly stems from the significant import component of public spending for fuel, medicines, parts, and equipment; constrained export capacity; loss of international capital market access; and foreign exchange (FX) transactions of Ukrainian migrants. The net drain on international reserves in 2022 is projected to reach about US$5.8 billion. Under the central scenario, reserves would drop to US$21.1 billion in 2023. Maintaining coverage of 80 percent of the ARA metric in 2023 would require additional external financing of about US$6 billion.[28] Assessing the desirable level of reserves, also taking into account the opportunity cost of holding precautionary reserves at the current juncture, will be the focus of future discussions. Downside risks include further damage to productive capacity, notably as a spillover from electrical grid issues, and the central scenario assumes that the impact of energy disruptions will only

Ukraine: Official Financing 1/
(US$ billion)

	2021	2022	2023
Financing Gap	3.0	32.7	39.5
Underlying BOP gap 2/	1.2	38.5	43.6
Official Financing	3.0	32.7	39.5
Bilateral and multilateral 3/	3.0	32.7	39.5
IMF	0.7	2.7	0.0
Other	2.3	29.9	39.5
World Bank	1.3	2.8	2.0
European Union	0.7	7.3	18.0
European Investment Bank	0.0	0.7	0.0
Bilateral loans	0.0	3.7	0.0
Bilateral grants	0.0	14.0	18.0
Other BOP support (EIB, EBRD, bilateral projects)	0.3	1.4	1.5
Residual BOP Gap			
Gross international reserves accumulation	1.8	-5.8	-4.1
Memorandum items:			
Capital market access	1.8	0.0	0.0
Gross international reserves	30.9	25.1	21.1
% of composite metric	98.8	80.0	61.6
GIR increase needed for composite metric of 80% 4/	...	...	6.3

Source: Ukrainian authorities and IMF staff estimates.

1/ This table reflects the forecast for the financing gap under the central scenario.

2/ Underlying BOP gap indicates the decrease in reserves absent official financing.

3/ Available data on multi- and bilateral commitments as of November 22, 2022.

4/ Represents an accumulation of gross internatinal reserves relative to the end-2023 projection, i.e., a level of US$ 27.3 billion that would be consistent with an IMF composite metric of 80 percent on current assumptions.

[27] On November 24th, European Parliament voted to approve a EUR 18 billion loan to support Ukraine during 2023 (see press release), but the decision remains subject also to European Council approval. US Congress is currently considering US$ 27.7 billion in additional aid for Ukraine, including US$14.5 billion for direct budget support, critical wartime investments and security assistance.

[28] This estimate is subject to large uncertainty given that it relies on 2024 projections to compute the denominator of the metric.

dissipate in the early spring. Other key downside risks are larger FX drains from additional emigration and monetization. While *de jure* risks to the grain corridor have lessened with the 120-day extension, *de facto* the risks remain high. A longer duration should be considered to ensure that progress on tackling the global food crisis is not reversed. A halt of the BSGI, should it occur in the near term, would entail a loss of agricultural export receipts of around US$1 billion in 2023. That impact would build over time as the profitability of agriculture is further strained, so the development of alternatives to seaborne shipping should be pursued to mitigate medium-term risks.

54. The debt sustainability analysis (DSA) has been updated to reflect revised macroeconomic assumptions, and its findings are broadly unchanged since the last DSA.[29] The debt outlook for 2022 has worsened by some 1.5 percent of GDP for 2022 compared with the most recent DSA. As previously stated, 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 the sustainability of Ukraine's debt, but the balance of probabilities suggests that there are higher risks of debt being unsustainable (see Annex II).

55. Ukraine's capacity to repay the Fund, given the assurances provided by creditors under the October 2022 RFI, is adequate but subject to exceptional risks. In order to allay the risks to the Fund, official bilateral donors and creditor have reaffirmed their recognition of the Fund's preferred creditor status in respect of the amounts outstanding to Ukraine, including the recent drawing by Ukraine under the new RFI Food Shock Window.[30] The stock of total Fund credit is expected to peak at 4 percent of GDP this year and 23 percent of gross reserves in 2024. Debt service to the Fund would peak at 1.2 percent of GDP and 14 percent of gross reserves in 2023 and 2025, respectively. Materialization of downside risks would increase these ratios significantly.

PROGRAM DESIGN

56. Quantitative targets under the PMB aim at a monitorable short-term strategy focused on macroeconomic stabilization and efforts to support sustainability. Targets are specified in Table 1 of the attached MEFP.

- *Fiscal.* The authorities' capacity to implement fiscal policy in the current circumstances will be assessed by establishing as a quantitative target (QT) a floor on the primary cash balance of the general government excluding defense-related activity and grants.[31] This is complemented by

[29] See Ukraine—Request for Purchase Under the Rapid Financing Instrument, Country Report No. 2022/323.

[30] See IMF press release No 22/343. Staff stated, at the time of the RFI, that these assurances offered sufficient safeguards, 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.

[31] Staff also included an adjustor on general government budget and project support to allow for additional spending on critical needs if partner financing is larger than expected.

an indicative target (IT) as a floor on the cash balance of the general government excluding grants.

- *External.* Given the prevailing uncertainty, the PMB also establishes a floor on net international reserves (NIR) based on conservative assumptions and aims to help protect external sustainability (QT). The targets were set to support an adequate level in reserves, including as a buffer against shortfalls in external financing, rising risk premia, and to potentially help meet import demand from unanticipated expenditure risks (such as gas or critical infrastructure repair).

- *Monetary.* The ceiling on general government borrowing from the NBU (IT), aims to control monetization in 2022 and eliminate it in 2023 with the aim of preserving price and external stability. An adjustor would allow for limited monetization to offset potential delays in external financing disbursements, which are not directly under the authorities' control, provided that efforts are undertaken to mobilize financing from the domestic bond market.

57. Achieving the objectives under the 4-month PMB will also depend on implementation of policy commitments laid out in the attached MEFP. There will be one test date under the PMB. Quantitative conditionality will be based on end-December 2022 test date, but the PMB staff report also includes end-March 2023 indicative targets to help guide the authorities' program implementation at the start of the year.[32] There will also be five structural benchmarks in areas critical for the PMB success (see Text Table). Furthermore, provision of data diminished after Russia's invasion (including because of Martial Law requirements), and the TMU specifies data provision requirements essential for staff to adequately monitor program implementation. The 4-month duration has been tailored to Ukraine's exceptional circumstances, whereas staff-monitored programs are usually longer. Under Fund policy, country authorities with PMBs can request an extension. Strong implementation under the PMB would help establish a track record, helping pave the way toward a possible future UCT-quality arrangement in 2023, while it will be critical for the authorities to continue taking strong measures to increase transparency including timely tracking and reporting of budget arrears, and advancing decisively on governance reforms.

[32] The 4-month duration has been tailored to Ukraine's exceptional circumstances, whereas staff-monitored programs are usually longer. Under Fund policy, country authorities with PMBs can request an extension.

Text Table. Ukraine: PMB Structural Benchmarks			
	Structural Benchmark	Sector	Timing
1	Develop an action plan to prevent and clear arrears over the course of the 2023 Budget and beyond.	Fiscal	End-January 2023
2	To support efforts to enhance tax revenues, submit to Parliament three draft laws: (i) on cancelling the moratoria on tax audits (effective July 1, 2023); (ii) on removing idiosyncrasies of the application of the simplified tax regime by taxpayers under the single tax of 2 percent, and restoring the pre-war regime for these taxpayers (effective 1 July, 2023); and (iii) on ensuring full-scale enforcement of the usage of cash registers in retail outlets (and associated settlement and payment infrastructure), including restoring liability for violations (effective July 1, 2023).	Fiscal	End-January 2023
3	Prepare a concept note on how to approach reforms to the social safety net to achieve targeted, adequate, and efficiently delivered social assistance to the population, including newly emerging categories of vulnerable groups, while safeguarding fiscal sustainability.	Fiscal	End-January 2023
4	Prepare a Terms of Reference in consultation with IMF staff describing the methodology and processes of bank diagnostics necessary to assess bank capital adequacy and identify NPL resolution priorities.	Financial sector	End-January 2023
5	Appoint and make fully operational the supervisory board of Naftogaz based on transparent and competitive selection procedures.	Governance	End-January 2023

STAFF APPRAISAL

58. The Russian invasion is having a devastating economic and social impact on Ukraine. Civilian casualties are mounting, over a third of the population has been displaced, and access to basic needs such as electricity, water, and heating is at risk while winter is coming. Macroeconomic management has been very difficult in these circumstances, and the authorities will need to continue adapting policies to fast changing circumstances, particularly under a severe downside scenario where further consideration of options will be needed, including on domestic financing mobilization to complement donor support.

59. Ukraine's balance of payments needs are very large and subject to exceptional risks. The next few months look extremely challenging due to sustained missile and drone attacks on critical civilian infrastructure. Accordingly, while staff's central scenario assumes economic stabilization in 2023, the range of plausible scenarios is extremely wide. Staff assesses that Ukraine would need US$39.5–US$57 billion in external financing in 2023 to meet fiscal and balance of payments needs. These estimates remain subject to considerable uncertainty and will likely change over time. Even under the central scenario, staff considers that spending pressures are large, especially stemming from the energy sector and need for social support, and likely to entail larger financing needs. Resources will also be needed to ensure an adequate level of international reserves.

60. The PMB aims to support the authorities' key policy objectives in a context of exceedingly high risks. The authorities' strategy involves ensuring adequate resources for core functions of the state, above all defense, while taking measures to maintain macroeconomic stability and further catalyze donor support. Uncertainties are exceptionally high, and it is important for the authorities to develop contingency plans so they can respond to shocks, as they have done since the start of the Russian invasion and prepare for the possible materialization of large shocks which could preclude full implementation of the program as originally envisaged, and may prove challenging for the authorities to fulfill all data requirements in a timely manner. Large, frontloaded, and predictable external financial support will be critical for the success of the strategy.

61. Efforts to boost domestic revenues and financing are critical given these large needs. The 2023 budget appropriately incorporates measures to increase tax revenues and the authorities have committed to developing an integrated roadmap of tax policy and administration measures restoring in the short-term tax administration and policies to their pre-war setup. Meanwhile, staff view stronger efforts to foster higher rollover rates on domestic debt markets as crucial: it is desirable and feasible to maintain overall domestic bank exposure to the sovereign, which would protect scarce financial resources in a context where spending needs are large and under pressure. Furthermore, this will also facilitate the elimination of monetary financing, thereby reducing risks to price and external stability. If downside risks materialize, the authorities should stand ready to identify alternative instruments and strategies to ramp up domestic financing to complement any additional donor support.

62. Monetary policy has been adequately tightened to help safeguard price and external stability. The very large fiscal deficit and the associated monetary financing have injected significant liquidity into the economy, putting pressure at times on the exchange rate, and impairing monetary transmission. Upside risks to inflation persist, reflecting headwinds from critical infrastructure damage, logistics bottlenecks and high input prices, and the passthrough of the summer hryvnia devaluation.

63. The exchange rate peg remains appropriate at present. The authorities continue to adjust FX measures to help balance the FX market and support exchange rate stability, while adapting to the needs of the economy. It will be important to continue monitoring key sources of FX leakages as well as the enforcement of these measures.

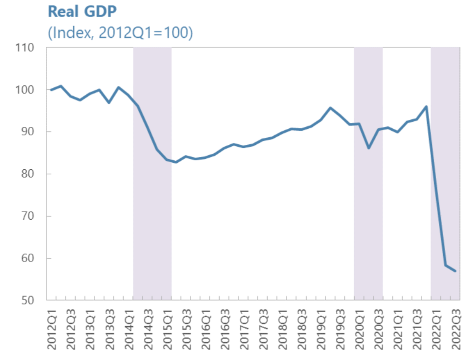
64. Staff welcomes the authorities plan to update the financial sector strategy adopted in 2021. This is an important step to prepare the transition away from emergency measures adopted since the beginning of the war and restore prudential norms. As robust bank diagnostics are critical to the success of the overall strategy, the NBU will set out the methodology and processes of future asset quality review and stress tests.

65. Transparency, governance, and anti-corruption remain important areas of engagement between the Fund and the authorities. Adequate and timely data provision—including on arrears—effective accountability mechanisms, and independent anti-corruption institutions are key to achieving a level playing field and thereby supporting the business environment and maintaining donor confidence. Developing and implementing an action plan to prevent and clear arrears will be vital for adequate monitoring of the fiscal position and to help ensure the liquidity of the corporate sector. Staff welcomes the authorities' commitment to sound corporate governance in SOEs and SOBs. Steadfast progress in all these areas will be a critical element for potential future program engagement.

66. Staff supports the authorities' request for a 4-month PMB. The authorities' economic program and policy commitments are an appropriate way forward under the current challenging circumstances and given the constraints facing the authorities. The proposed set of quantitative conditionality and structural benchmarks has been tailored to the country's immediate challenges and is aimed at maintaining stability and preparing the post-war era. Accordingly, conditionality is focused on key fiscal areas, financial sector strategy, and governance. Adequate and timely data provision, including on budget arrears, progress in governance and strong implementation in all areas under the PMB would help catalyze additional donor financing and help pave the way toward a possible future upper credit tranche quality arrangement in 2023.

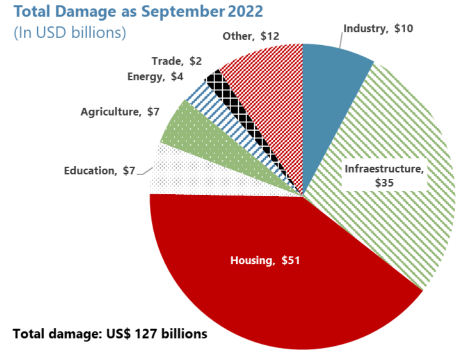
Figure 1. Ukraine: Real Sector Developments

The war has driven the sharpest contraction in output on record…



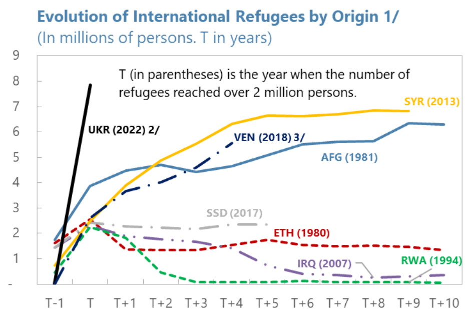
Source: State Statistics Service of Ukraine and IMF staff estimations.

…as damage to physical infrastructure mounts.



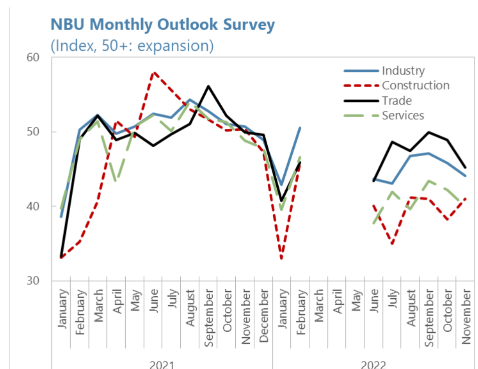
Source: Kyiv School of Economics.

A fifth of the population has left Ukraine; a similar number are internally displaced.



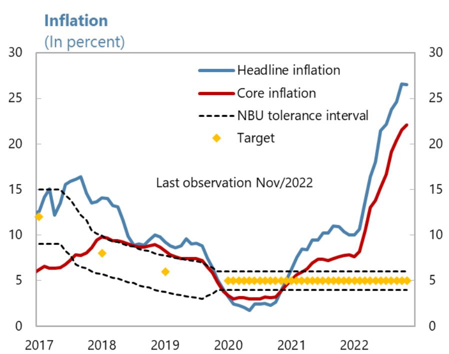
1/ Only showing countries with more than 2 million refugees.
2/ Showing Ukranian refugees in Europe only.
3/ Other people in need of international protection considered refugees.
Source: UNHCR. IMF staff estimates.

Economic activity has started to recover in noncombat zones, though stabilizing at a lower than pre-war level



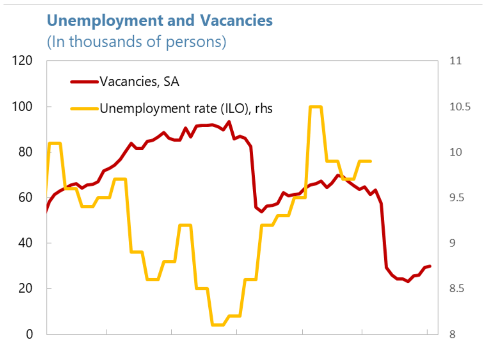
Source: NBU.

Inflation has continued to accelerate…



Source: State Statistics Commitee of Ukraine; NBU; Bloomberg; Haver Analytics

…and dislocations in the labor market persist

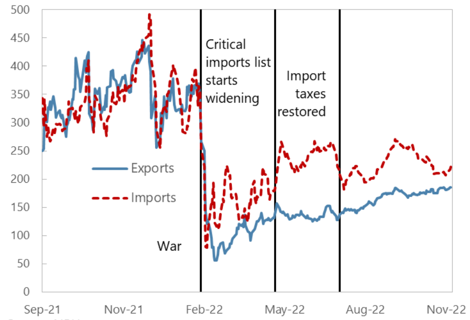


Source: Haver Analytics.

Figure 2. Ukraine: External Sector Developments

Following a sharp initial decline, exports have recovered more slowly than imports…

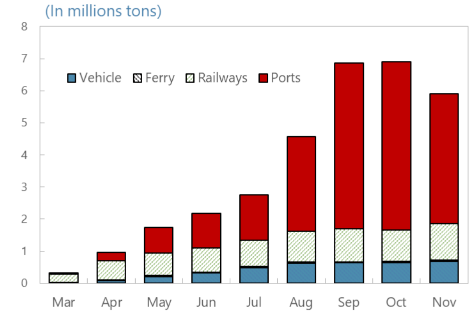
Exports and Imports
(5-day moving average, in USD millions)



Source: NBU.

… and though agricultural exports have been boosted by the grain corridor, they remain below prewar levels.

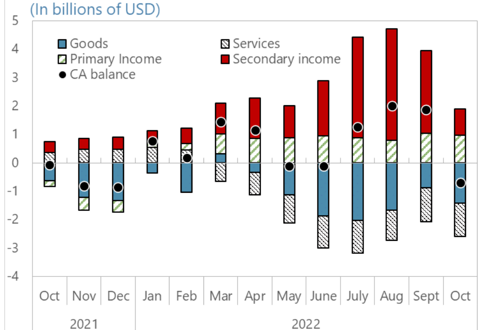
Exports of Agricultural Products, by Mode of Transportation, 2022
(In millions tons)



Source: Ministry of Food Policy and Agriculture

The widening trade balance has been offset by large transfers

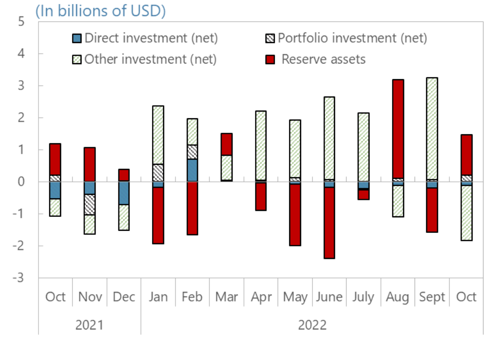
Current Account, by Component
(In billions of USD)



Source: NBU.

Amid capital controls, external financing has helped support reserves levels.

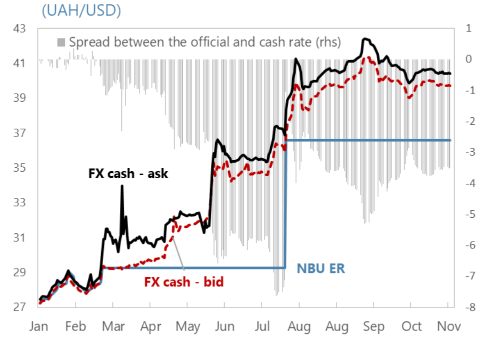
Financial Account, by Component
(In billions of USD)



Source: NBU.

The devaluation of the official exchange rate helped narrow the differential with the cash rate, though the gap persists

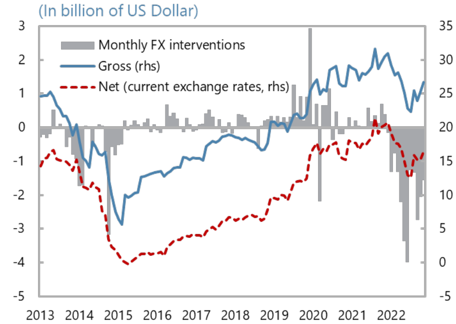
Exchange Rates in 2022
(UAH/USD)



Source: NBU.

The NBU has had to consistently sell in the FX market to meet FX demand

International Reserves
(In billion of US Dollar)

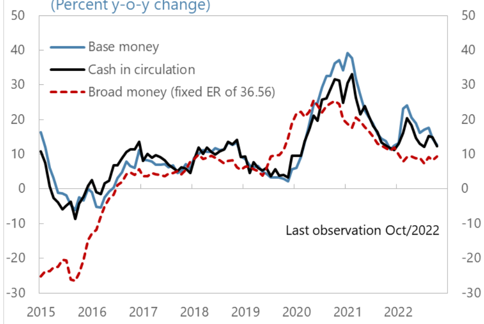


Source: NBU.

Figure 3. Ukraine: Monetary Developments

Base money growth has remained contained despite monetary financing…

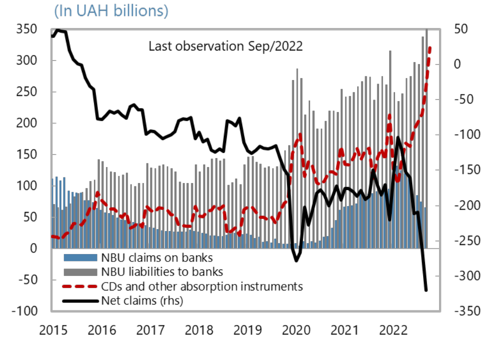
Money Growth
(Percent y-o-y change)



Sources: NBU.

…sterilized by FX intervention and NBU CDs, whose stock has continued to increase.

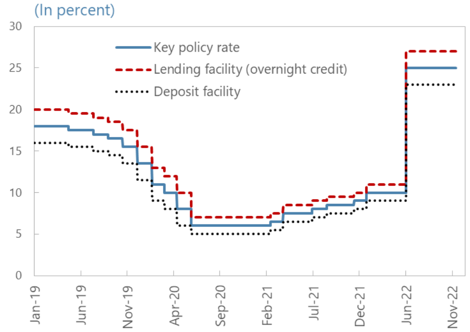
NBU Claims on and Liabilites to Banks
(In UAH billions)



Sources: NBU.

Whereas the rate hike has been transmitted to the interbank market…

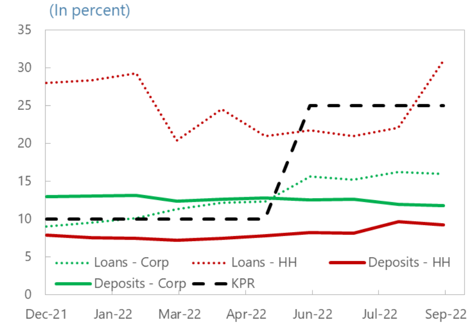
Interest Rates on Monetary Policy Facilities
(In percent)



Sources: NBU.

…the transmission to retail rates has been more gradual.

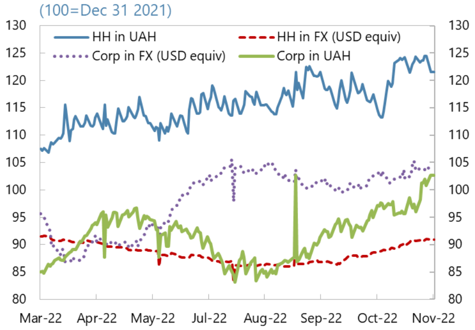
Interest Rates on New Loans and Deposits
(In percent)



Sources: NBU.

Hryvnia deposits have been robust amid withdrawal restrictions…

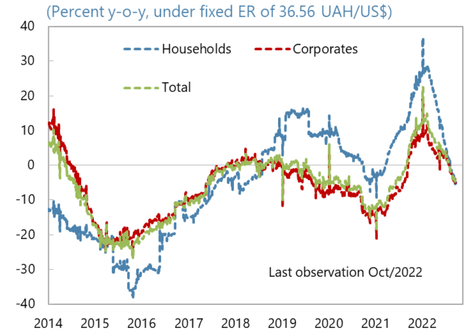
Index of Deposits
(100=Dec 31 2021)



Sources: NBU.

…while credit growth has slowed.

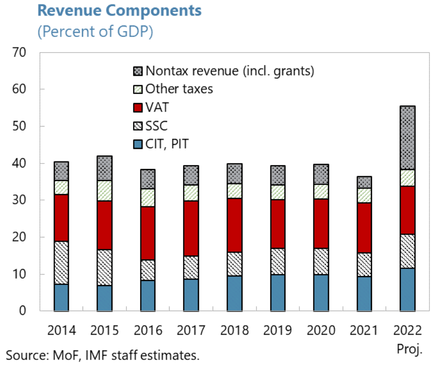
Change in Banking System Loans
(Percent y-o-y, under fixed ER of 36.56 UAH/US$)



Sources: NBU.

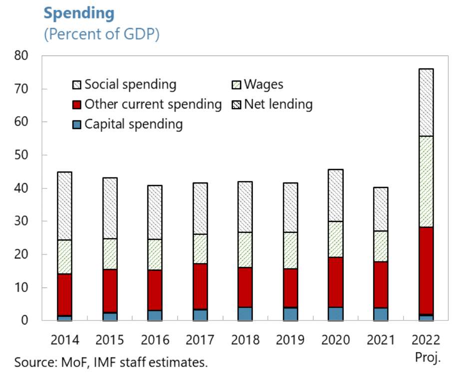
Figure 4. Ukraine: Fiscal Sector Indicators

Revenues have been lifted by grants...



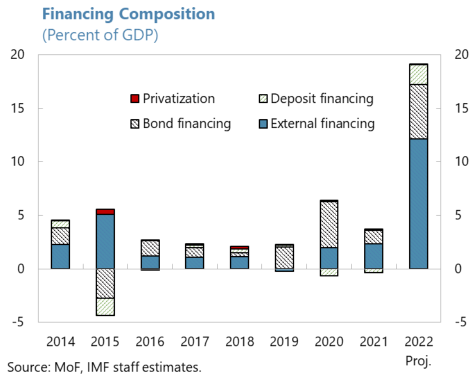
Source: MoF, IMF staff estimates.

...as expenditures have been driven by defense expenditures and social payments



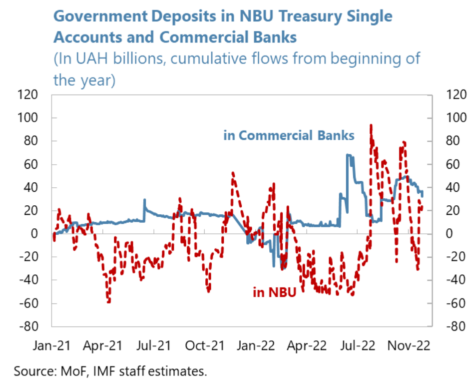
Source: MoF, IMF staff estimates.

The large fiscal deficit has been financed by significant external support



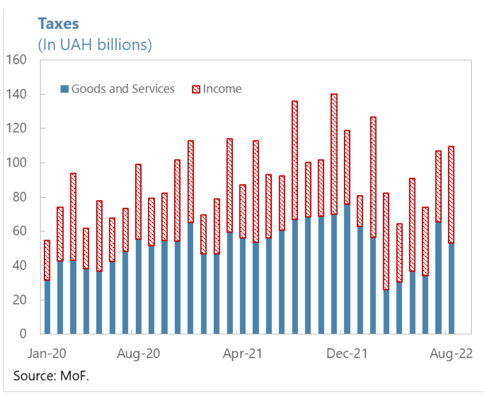
Source: MoF, IMF staff estimates.

...while government deposits have fluctuated amid uncertainty in the timing of external disbursements.



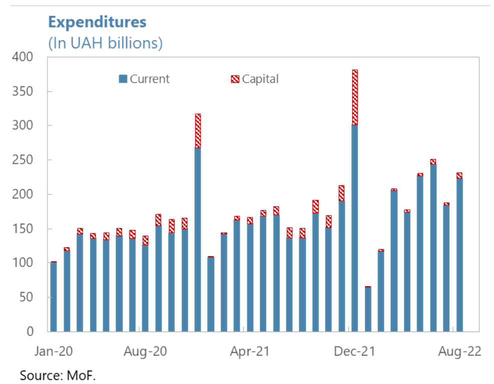
Source: MoF, IMF staff estimates.

Tax revenues have been hit by the decline in economic activity, though the reversal of some exemptions has lifted revenues in recent months.



Source: MoF.

Expenditures remain elevated to support the war effort, amid a compression in capital expenditure.



Source: MoF.

Table 1. Ukraine: Selected Economic and Social Indicators, 2019–2023

	2019	2020	2021	2022		2023
	Act.	Act.	Act.	RFI Oct 2022	Proj.	Proj.
Real economy (percent change, unless otherwise indicated)						
Nominal GDP (billions of Ukrainian hryvnias) 1/	3,977	4,222	5,460	4,567	4,700	6,100
Real GDP 1/	3.2	-3.8	3.4	-35.0	-33.0	1.0
Contributions:						
Domestic demand	3.0	-4.1	12.9	-34.6	-30.3	5.5
Private consumption	8.1	1.2	5.2	-19.3	-15.3	2.3
Public consumption	-2.6	-0.1	0.3	4.9	5.2	4.0
Investment	-2.6	-5.1	7.4	-20.2	-20.2	-0.8
Net exports	0.2	0.3	-9.6	-0.4	-2.7	-4.5
GDP deflator	8.2	10.3	25.1	28.6	28.5	28.5
Output gap (percent of potential GDP)	-0.7	-3.4	-1.7	-8.2	-7.4	-3.5
Unemployment rate (ILO definition; period average, percent)	8.5	9.2	9.8	24.5	24.5	20.9
Consumer prices (period average)	7.9	2.7	9.4	20.6	20.6	25.0
Consumer prices (end of period)	4.1	5.0	10.0	30.0	30.0	22.5
Nominal wages (average)	18.5	10.4	20.8	-12.0	-12.0	21.9
Real wages (average)	9.5	7.5	10.5	-27.0	-27.0	-2.5
Savings (percent of GDP)	12.2	12.2	12.2	11.1	12.9	5.9
Private	10.4	14.2	12.4	32.9	30.2	14.3
Public	1.8	-1.9	-0.2	-21.8	-17.3	-8.4
Investment (percent of GDP)	14.9	8.9	13.8	8.4	8.4	9.9
Private	11.0	4.9	10.0	7.4	7.0	7.1
Public	3.9	4.0	3.8	1.0	1.5	2.8
Gross fixed capital formation (percent of GDP)	17.6	13.4	12.4	6.3	5.4	6.5
General Government (percent of GDP)						
Fiscal balance 2/	-2.1	-5.9	-3.9	-19.8	-20.5	-9.1
Fiscal balance, excl. grants 2/	-2.1	-6.0	-4.0	-28.2	-30.3	-21.6
External financing (net)	-0.2	2.0	2.4	13.5	12.1	13.3
Domestic financing (net), of which:	2.3	4.0	1.6	3.5	6.9	-4.3
NBU	-0.3	-0.3	-0.3	8.5	8.3	-0.2
Commercial banks	2.3	4.6	1.5	-5.2	-2.2	-0.4
Public and publicly-guaranteed debt	50.5	60.6	47.6	87.8	89.4	89.9
Money and credit (end of period, percent change)						
Base money	9.6	24.8	11.2	14.8	14.8	9.0
Broad money	12.6	28.6	12.0	18.6	17.0	15.0
Credit to nongovernment	-9.8	-3.1	8.4	8.4	3.4	2.0
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	4.4	-4.0
Foreign direct investment	3.4	-0.1	3.4	0.1	0.4	0.8
Gross reserves (end of period, billions of U.S. dollars)	25.3	29.1	30.9	24.8	25.1	21.1
Months of next year's imports of goods and services	4.8	4.2	4.5	3.4	3.0	2.5
Percent of short-term debt (remaining maturity)	53.3	58.6	68.5	60.6	58.9	45.8
Percent of the IMF composite metric (float)	88.9	98.1	98.8	81.8	80.0	61.6
Goods exports (annual volume change in percent)	6.4	11.2	34.3	-29.5	-34.7	-2.9
Goods imports (annual volume change in percent)	7.2	-3.3	17.2	-24.5	-31.8	23.8
Goods terms of trade (percent change)	4.8	12.0	-5.2	-16.8	-16.8	0.2
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	2.1	12.0	…	…	…
Memorandum items:						
Real GDP as share of 2021 Real GDP	101	97	100	65	67	68
Per capita GDP / Population (2017): US$2,640 / 44.8 million						
Literacy / Poverty rate (2022 est 3/): 100 percent / 25 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, 2019–2023 1/

(Billions of Ukrainian Hryvnia)

	2019	2020	2021	2022		2023
	Act.	Act.	Proj.	RFI Oct 2022	Proj.	Proj.
Revenue	1,567.8	1,675.4	1,982.7	1,914.9	2,605.6	2,894.7
Tax revenue	1,358.6	1,446.4	1,816.8	1,384.7	1,802.7	1,959.1
Tax on income, profits, and capital gains	392.8	413.6	513.6	414.9	548.5	525.7
Personal income tax	275.5	295.1	349.8	307.9	414.1	403.1
Corporate profit tax	117.3	118.5	163.8	107.1	134.4	122.6
Social security contributions	279.1	300.2	350.7	353.7	428.4	400.0
Property tax	38.0	37.4	43.2	30.7	36.7	36.8
Tax on goods and services	526.6	565.4	730.8	498.5	608.5	791.6
VAT	378.7	400.6	536.5	394.8	481.9	617.4
Excise	137.1	153.9	180.3	99.1	116.0	161.5
Other	10.9	11.0	14.0	4.6	10.6	12.7
Tax on international trade	30.1	30.5	38.2	8.4	26.6	37.9
Other tax	92.1	99.3	140.2	78.5	153.8	167.1
Nontax revenue	209.2	229.0	165.9	530.1	803.0	935.6
Grants	1.2	1.2	1.3	384.5	461.9	763.4
Expenditure	1,650.7	1,925.3	2,198.3	2,820.4	3,569.4	3,447.7
Current	1,492.9	1,750.9	1,986.7	2,752.1	3,472.3	3,150.1
Compensation of employees	439.6	462.8	507.4	925.5	1,286.1	944.4
Goods and services	260.4	373.9	482.7	669.1	887.2	848.1
Interest	120.8	122.2	155.0	161.3	158.8	334.1
Subsidies to corporations and enterprises	80.9	133.6	116.2	130.6	176.3	105.2
Social benefits	588.9	657.4	724.5	863.9	953.0	916.0
Social programs (on budget)	130.1	130.5	153.7	246.7	301.8	240.2
Pensions	421.0	475.8	518.7	562.3	594.3	629.6
Unemployment, disability, and accident	37.8	51.2	52.1	54.9	56.9	46.2
Other current expenditures	2.4	1.1	0.9	1.7	10.9	2.2
Capital	153.7	169.0	206.9	44.1	69.2	171.7
Net lending	4.0	5.3	4.8	23.5	23.5	45.1
Contingency reserve 2/	0.0	0.0	0.0	0.7	4.4	80.8
General government overall balance	-82.8	-249.9	-215.6	-905.5	-963.8	-553.0
General government overall balance, excluding grants	-84.0	-251.0	-217.0	-1,290.0	-1,425.8	-1,316.4
General government financing	82.8	249.9	215.6	776.4	896.1	553.0
External	-9.3	82.8	128.7	616.8	569.9	813.9
Disbursements	80.2	210.2	239.1	667.8	628.6	911.8
Amortizations	-89.5	-127.4	-110.3	-51.0	-58.7	-97.9
Domestic (net)	92.1	167.1	86.9	159.6	326.2	-260.8
Bond financing 3/	81.5	182.9	68.4	102.2	240.8	-63.8
o/w NBU	-11.1	-12.9	-13.7	388.5	388.5	-14.6
o/w Commercial banks	92.7	195.8	82.0	-238.6	-101.2	-25.0
Direct bank borrowing	1.7	6.7	30.0	0.0	0.0	0.0
Deposit finance	7.2	-26.2	-18.9	57.0	85.0	-203.0
Privatization	1.6	3.7	7.4	0.4	0.4	6.0
Financing Gap/unindentified measures (-gap/+surplus)	0.0	0.0	0.0	-129.1	-67.7	0.0
Bank and DGF recapitalization	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:						
Primary balance	38.0	-127.7	-60.7	-615.1	-804.3	-219.0
Public and publicly-guaranteed debt	2,008	2,557	2,598	4,011	4,134	4,921
Nominal GDP (billions of Ukrainian hryvnia)	3,977	4,222	5,460	4,567	4,700	6,100

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, 2019–2023 1/

(Percent of GDP)

	2019	2020	2021	2022		2023
	Act.	Act.	Proj.	RFI Oct 2022	Proj.	Proj.
Revenue	39.4	39.7	36.3	41.9	55.4	47.5
Tax revenue	34.2	34.3	33.3	30.3	38.4	32.1
Tax on income, profits, and capital gains	9.9	9.8	9.4	9.1	11.7	8.6
Personal income tax	6.9	7.0	6.4	6.7	8.8	6.6
Corporate profit tax	2.9	2.8	3.0	2.3	2.9	2.0
Social security contributions	7.0	7.1	6.4	7.7	9.1	6.6
Property tax	1.0	0.9	0.8	0.7	0.8	0.6
Tax on goods and services	13.2	13.4	13.4	10.9	12.9	13.0
VAT	9.5	9.5	9.8	8.6	10.3	10.1
Excise	3.4	3.6	3.3	2.2	2.5	2.6
Other	0.3	0.3	0.3	0.1	0.2	0.2
Tax on international trade	0.8	0.7	0.7	0.2	0.6	0.6
Other tax	2.3	2.4	2.6	1.7	3.3	2.7
Nontax revenue	5.3	5.4	3.0	11.6	17.1	15.3
Grants	0.0	0.1	0.0	8.4	9.8	12.5
Expenditure	41.5	45.6	40.3	61.8	75.9	56.5
Current	37.5	41.5	36.4	60.3	73.9	51.6
Compensation of employees	11.1	11.0	9.3	20.3	27.4	15.5
Goods and services	6.5	8.9	8.8	14.7	18.9	13.9
Interest	3.0	2.9	2.8	3.5	3.4	5.5
Subsidies to corporations and enterprises	2.0	3.2	2.1	2.9	3.8	1.7
Social benefits	14.8	15.6	13.3	18.9	20.3	15.0
Social programs (on budget)	3.3	3.1	2.8	5.4	6.4	3.9
Pensions	10.6	11.3	9.5	12.3	12.6	10.3
Unemployment, disability, and accident insurance	1.0	1.2	1.0	1.2	1.2	0.8
Other current expenditures	0.1	0.0	0.0	0.0	0.2	0.0
Capital	3.9	4.0	3.8	1.0	1.5	2.8
Net lending	0.1	0.1	0.1	0.5	0.5	0.7
Contingency reserve 2/	0.0	0.0	0.0	0.0	0.1	1.3
General government overall balance	-2.1	-5.9	-3.9	-19.8	-20.5	-9.1
General government overall balance, excluding grants	-2.1	-5.9	-4.0	-28.2	-30.3	-21.6
General government financing	2.1	5.9	3.9	17.0	19.1	9.1
External	-0.2	2.0	2.4	13.5	12.1	13.3
Disbursements	2.0	5.0	4.4	14.6	13.4	14.9
o/w IFIs	0.6	1.6	1.4	5.5	5.8	16.9
o/w IMF budget support	0.0	1.3	0.4	2.0	1.9	0.0
Amortizations	-2.3	-3.0	-2.0	-1.1	-1.2	-1.6
Domestic (net)	2.3	4.0	1.6	3.5	6.9	-4.3
Bond financing 3/	2.1	4.3	1.3	2.2	5.1	-1.0
o/w NBU	-0.3	-0.3	-0.3	8.5	8.3	-0.2
o/w Commercial banks	2.3	4.6	1.5	-5.2	-2.2	-0.4
Direct bank borrowing	0.0	0.2	0.5	0.0	0.0	0.0
Deposit finance	0.2	-0.6	-0.3	1.2	1.8	-3.3
Privatization	0.0	0.1	0.1	0.0	0.0	0.1
Financing Gap/undidentified measures (-gap/+surplus)	0.0	0.0	0.0	-2.8	-1.4	0.0
Bank and DGF recapitalization	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:						
Primary balance	1.0	-3.0	-1.1	-13.5	-17.1	-3.6
Public and publicly-guaranteed debt	48.7	60.6	47.6	87.8	89.4	89.9
Nominal GDP (billions of Ukrainian hryvnia)	3,977	4,222	5,460	4,567	4,700	6,100

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, 2019–2023 1/ 2/

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

	2019	2020	2021	2022		2023
	Act.	Act.	Act.	RFI Oct 2022	Proj.	Proj.
Current account balance	-4.2	5.2	-3.2	3.7	6.4	-5.7
Goods (net)	-14.3	-6.9	-6.6	-18.6	-15.9	-30.4
Exports	46.1	45.1	63.1	44.2	40.9	39.7
Imports	-60.4	-52.0	-69.8	-62.8	-56.8	-70.1
Of which : gas	-2.8	-1.2	-3.4	-2.7	-2.7	-8.6
Services (net)	1.8	4.4	4.0	-4.4	-9.9	-11.9
Receipts	17.3	15.6	18.4	15.8	16.0	17.9
Payments	-15.6	-11.2	-14.4	-20.2	-25.9	-29.8
Primary income (net)	1.9	3.5	-5.2	9.0	9.8	12.5
Secondary income (net)	6.5	4.1	4.6	17.7	22.4	24.1
Capital account balance	0.0	0.0	0.0	0.1	0.0	0.0
Financial account balance	-7.9	2.0	-5.0	5.1	10.8	-3.2
Direct investment (net)	-5.2	0.1	-6.9	-0.1	-0.6	-1.1
Portfolio investment (net)	-5.1	0.8	-1.0	2.4	1.5	0.9
Portfolio investment: assets	0.4	0.2	-0.1	0.2	0.2	0.0
Portfolio investment: liabilities	5.5	-0.7	1.0	-2.3	-1.3	-0.9
Financial derivatives (net)	0.0	0.0	0.0	0.0	0.0	0.0
Other investment (net)	2.4	1.0	2.9	2.8	9.9	-3.0
Other investment: assets	5.9	6.3	7.7	20.8	28.5	17.2
Other investment: liabilities	3.5	5.3	4.9	18.0	18.6	20.2
Net use of IMF resources for budget support	-1.0	2.1	0.3	2.3	2.1	-0.9
Central Bank	0.0	0.0	2.7	-1.0	-0.1	0.0
General government	1.0	1.2	1.5	21.6	15.2	20.2
Banks 3/	-0.3	-0.2	0.4	-1.2	-0.2	0.0
Other sectors	3.8	2.2	0.0	-3.7	1.6	1.0
Errors and omissions	1.2	0.8	1.8	0.4	0.8	0.0
Unidentified financing need	0.0	0.0	0.0	-4.0	0.0	0.0
Overall balance	4.9	4.0	3.6	-0.8	-3.5	-2.5
Financing	-5.1	-4.0	-3.6	0.8	3.5	2.5
Gross official reserves (increase: -)	-4.5	-2.9	-2.7	6.5	5.0	4.1
Net use of IMF resources for BOP support	-0.6	-1.1	-0.9	-1.6	-1.4	-1.6
Unidentified financing need				-4.0		0.0
Memorandum items:						
Current account balance (percent of GDP)	-2.7	3.3	-1.6	2.7	4.4	-4.0
Goods and services trade balance (percent of GDP)	-8.2	-1.6	-1.3	-16.6	-17.8	-29.4
Gross international reserves	25.3	29.1	30.9	24.8	25.1	21.1
Months of next year's imports of goods and services	4.8	4.2	4.5	3.4	3.0	2.5
Percent of the IMF composite metric	88.9	98.1	98.8	81.8	80.0	61.6
GIR increase needed for IMF composite metric of 80 percent 4/	…	…	…	…	…	6.3

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.

4/ Represents an accumulation of gross internatinal reserves relative to the end-2023 projection, i.e., a level of US$ 27.3 billion that would be consistent with an IMF composite metric of 80 percent on current assumptions.

Table 4. Ukraine: Gross External Financing Requirement, 2019–2023

(Billions of U.S. dollars)

	2019	2020	2021	2022		2023
	Act.	Act.	Act.	RFI Oct 2022	Proj.	Proj.
A. Total financing requirements	**41.2**	**30.9**	**37.2**	**58.2**	**65.1**	**67.9**
Current account deficit (excluding grants)	4.2	-5.2	3.2	6.8	7.6	23.7
Portfolio investment	5.6	7.2	4.9	2.7	1.8	0.9
Private	1.7	1.2	0.6	0.6	0.6	0.4
General government	3.9	6.0	4.3	2.1	1.2	0.5
Medium and long-term debt	4.4	4.9	3.9	4.6	3.8	3.6
Private	3.8	3.5	2.7	2.8	2.8	2.8
Banks	0.4	0.4	0.2	0.5	0.5	0.5
Corporates	3.4	3.1	2.5	2.3	2.3	2.3
General government	0.6	1.4	1.2	1.8	1.0	0.7
Short-term debt (including deposits)	7.8	3.1	0.8	6.4	6.4	6.4
Other net capital outflows 1/	5.9	6.3	8.6	20.8	28.5	17.2
Trade credit	13.3	14.6	15.7	16.9	16.9	16.1
B. Total financing sources	**45.2**	**30.6**	**36.3**	**19.9**	**28.7**	**26.8**
Capital transfers	0.0	0.0	0.0	0.1	0.0	0.0
Direct investment, net	5.2	-0.1	6.9	0.1	0.6	1.1
Portfolio investment	10.7	6.3	6.0	0.1	0.2	0.0
Private	2.6	0.7	1.8	0.0	0.0	0.0
General government	8.1	5.7	4.2	0.1	0.2	0.0
Of which: Market financing	2.4	4.6	1.8	0.0	0.0	0.0
Medium and long-term debt	4.8	4.9	5.4	2.6	5.1	2.2
Private	4.0	2.3	2.3	2.6	5.2	2.8
Banks	1.4	0.3	0.2	0.4	0.4	0.5
Corporates	2.6	2.0	2.1	2.2	4.7	2.3
General government	0.8	2.6	3.1	0.0	-0.1	-0.6
Short-term debt (including deposits)	10.0	3.3	1.1	3.4	6.6	6.4
Trade credit	14.5	16.2	16.9	13.5	16.2	17.1
C. Financing needs (A - B)	**-4.1**	**0.2**	**0.9**	**38.3**	**36.4**	**41.1**
Unidentified fiscal financing need	0.0	0.0	0.0	4.0	0.0	0.0
D. Total exceptional financing needs	**-4.1**	**0.2**	**0.9**	**42.3**	**36.4**	**41.1**
E. Official financing	**-0.8**	**2.3**	**1.7**	**31.4**	**30.6**	**37.0**
IMF	-1.6	1.0	-0.7	0.7	0.7	-2.5
Purchases	0.0	2.1	0.7	2.7	2.7	0.0
Repurchases	1.6	1.1	1.4	2.1	2.1	2.5
Official grants	0.0	0.0	0.0	10.5	14.0	18.0
o/w U.S.	0.0	0.0	0.0	8.5	11.5	…
Official creditors	0.8	1.4	2.3	20.2	15.9	21.5
World Bank	0.2	0.0	1.3	2.6	3.0	2.0
EU	0.0	1.3	0.7	10.3	7.3	18.0
Other 2/	0.6	0.1	0.3	7.4	5.6	1.5
F. Increase in reserves	**4.5**	**2.9**	**2.7**	**-6.5**	**-5.0**	**-4.1**
G. Errors and omissions	**1.2**	**0.8**	**1.8**	**0.4**	**0.8**	**0.0**
Financing Gap (D - E + F - G)	0.0	0.0	0.0	4.0	0.0	0.0
Memorandum items:						
Gross international reserves	25.3	29.1	30.9	24.8	25.1	21.1
Months of next year's imports of goods and services	4.8	4.2	4.5	3.4	3.0	2.5
Percent of short-term debt (remaining maturity)	53.3	58.6	68.5	60.6	58.9	45.8
Percent of the IMF composite metric 3/	88.9	98.1	98.8	81.8	80.0	61.6
GIR increase needed for IMF composite metric of 80 percent 4/	…	…	…	…	…	6.3
Loan rollover rate (percent)						
Banks	97.2	94.2	97.2	80.0	97.0	100.0
Corporates	101.2	62.6	89.3	89.3	173.7	100.0
Total	98.6	74.9	91.4	83.8	124.5	100.0

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 swap transactions.

2/ Includes bilateral and other multilateral budget and project support; October 2022 RFI column includes bilateral budget support under other official financing.

3/ 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.

4/ Represents an accumulation of gross internatinal reserves relative to the end-2023 projection, i.e., a level of US$ 27.3 billion that would be consistent with an IMF composite metric of 80 percent on current assumptions.

Table 5. Ukraine: Monetary Accounts, 2019–2023

(Billions of Ukrainian Hryvnia)

	2019	2020	2021	2022		2023
	Act.	Act.	Act.	RFI Oct 2022	Proj.	Proj.
Monetary survey						
Net foreign assets	714	977	1,002	1,088	1,184	1,499
Net domestic assets	724	873	1,070	1,368	1,240	1,288
Domestic credit	1,647	1,321	1,392	1,679	1,771	1,550
Net claims on government	664	368	364	565	710	467
Credit to the economy	974	944	1,023	1,109	1,057	1,078
Domestic currency	616	596	731	866	818	886
Foreign currency	358	348	292	242	239	192
Other claims on the economy	8	9	5	5	4	5
Other items, net	-923	-448	-322	-310	-531	-262
Broad money	1,438	1,850	2,071	2,457	2,423	2,787
Currency in circulation	384	516	581	666	637	676
Total deposits	1,051	1,331	1,489	1,789	1,785	2,109
Domestic currency deposits	641	837	1,014	1,248	1,155	1,359
Foreign currency deposits	410	494	474	540	630	750
Accounts of the NBU						
Net foreign assets	617	826	852	849	849	989
Net international reserves	599	821	838	830	830	965
(In billions of U.S. dollars)	25.3	29.0	30.7	…	…	…
Reserve assets	599	824	843	907	919	963
Other net foreign assets	18	4	14	19	19	24
Net domestic assets	-140	-230	-190	-89	-88	-160
Net domestic credit	183	197	175	263	483	118
Net claims on government	309	267	270	679	685	619
Claims on government	348	337	325	724	721	706
Net claims on banks	-126	-70	-95	-416	-202	-501
Other items, net	-323	-426	-365	-351	-571	-278
Base money	477	596	662	761	761	829
Currency in circulation	384	516	581	666	637	676
Banks' reserves	93	80	81	95	124	153
Cash in vault	41	42	47	56	56	66
Correspondent accounts	52	38	35	39	68	87
Deposit money banks						
Net foreign assets	96	151	149	239	335	510
Foreign assets	214	262	254	317	452	638
Foreign liabilities	117	111	105	78	117	128
Net domestic assets	954	1,180	1,339	1,549	1,450	1,599
Domestic credit	1,599	1,247	1,342	1,554	1,455	1,628
Net claims on government 1/	355	102	94	-113	25	-152
Credit to the economy	974	944	1,023	1,108	1,057	1,078
Other claims on the economy	8	9	5	5	4	5
Net claims on NBU	261	193	220	554	369	697
Other items, net	-644	-67	-3	-4	-5	-29
Banks' liabilities	1,051	1,331	1,488	1,789	1,785	2,109
Memorandum items:	(End of period, percent change unless otherwise noted)					
Base money	9.6	24.8	11.2	14.8	14.8	9.0
Currency in circulation	5.7	34.3	12.6	14.6	9.6	6.2
Broad money	12.6	28.6	12.0	18.6	17.0	15.0
Credit to the economy	-9.8	-3.1	8.4	8.4	3.4	2.0
Real credit to the economy 2/	-13.3	-7.7	-1.5	-16.6	-20.5	-16.7
Credit-to-GDP ratio, in percent	24.5	22.5	0.0	24.3	22.5	17.7
Velocity of broad money, ratio	2.8	2.1	1.9	1.9	1.9	2.2
Money multiplier, ratio	3.0	3.1	3.1	3.2	3.2	3.4
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	7,608	5,704	3,924	2,187	690	0
Obligations	1,408	994	1,152	374	2,320	2,066	1,914	1,615	711
Principal (repurchases)	1,153	788	969	125	1,905	1,780	1,736	1,498	690
Interest charges	255	206	183	249	415	286	177	117	21
Stock of existing and prospective Fund credit 1/	6,883	7,595	6,626	7,608	5,704	3,924	2,187	690	0.0
In percent of quota 2/	342	378	329	378	284	195	109	34	0.0
In percent of GDP	3.2	3.4	2.4	4.0	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	10.1	7.4	4.6	2.6	0.8	0.0
In percent of gross reserves	19.7	18.1	15.3	22.8	20.3	22.9	16.0	4.6	0.0
In percent of public external debt	10.7	10.3	8.8	8.6	5.1	3.4	1.9	0.6	0.0
Obligations to the Fund from existing and prospective Fund credit	1,408	994	1,152	374	2,320	2,066	1,914	1,615	711
In percent of quota	70.0	49.4	57.3	18.6	115.3	102.7	95.1	80.3	35.3
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	0.5	3.0	2.4	2.3	1.9	0.8
In percent of gross reserves	4.0	2.4	2.7	1.1	8.3	12.1	14.0	10.7	3.9
In percent of public external debt service	22.8	12.8	19.6	6.4	48.9	18.7	17.4	14.7	6.5

Source: Fund staff estimates and projections.

1/ End of period.

2/ Ukraine's quota is SDR 2011.8 million effective since February 2016.

Table 7. Ukraine: Quantitative Targets and Indicative Targets 1/

(End of period; millions of Ukrainian hryvnias, unless otherwise indicated)

	2022	2023
	December	March
	QT	IT
I. Quantitative performance criteria		
Floor on the non-defense cash primary balance of the general government, excluding grants (- implies a deficit) 2/	86,950	-8,240
Floor on net international reserves (in millions of U.S. dollars) 3/	15,000	11,500
II. Indicative Targets		
Floor on the overall cash balance of the general government, excluding grants (- implies a deficit) 2/	-1,425,762	-506,476
Ceiling on general government borrowing from the NBU 1/ 2/ 4/	388,500	-7,600
III. Memorandum Items		
External project financing 2/	51,733	13,713
Budget support grants 2/	461,940	182,843
Budget support loans 2/	577,814	164,559
NBU profit transfers to the government 2/	19,700	71,000
Net financing of general government deficit by commercial banks 2/	-101,223	-5,434
Government bonds for the purposes of bank recapitalization and DGF financing	0	0
Called guaranteed debt principal 2/	15,000	10,500

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

1/ Definitions and adjustors are specified in the Technical Memorandum of Understanding (TMU).

2/ Targets and projections for 2022 are cumulative flows from January 1, 2022. Targets and projections for 2023 are cumulative flows from January 1, 2023.

3/ Calculated using program accounting exchange rates as specified in the TMU.

4/ Calculated using the projected redemption of government bonds for 2022Q4 and 2023Q1 respectively as of November 22, 2022.

Annex I. Risk Assessment Matrix 1/

Risks and Risk Likelihood		Expected Impact	Policy Response
External Risks			
Intensification of Russia's war in Ukraine.	High	**High.** In addition to increased loss of life, an intensifying war would lead to further destruction of capital stock, outward migration and internal displacement. The recovery is stalled, and growth falls sharply. Restrictions on seaport access and logistical challenges curtail the recovery of exports, while import needs rise (for defense, energy and infrastructure repair), widening fiscal and external financing needs. Financing constraints raise the risk of resort to monetary financing, increasing inflation and raising pressures on the exchange rate. High inflation further erodes purchasing power and increases poverty. Weak activity weighs on bank and SOE balance sheets.	Maintain appropriate macroeconomic policies to safeguard macroeconomic and financial stability. Mobilize domestic financing to help meet fiscal financing needs and seek additional external financing on concessional terms. Prepare contingency plans for the financial sector.
Commodity price shocks. A combination of continuing supply disruptions (e.g., due to conflicts and export restrictions) and negative demand shocks causes recurrent commodity price volatility and social and economic instability	High	**High.** High energy prices can further strain consumption and business activity and widen fiscal and external financing needs. Low and/or volatile prices for agriculture products amid logistical costs can alter sowing decisions for future agriculture seasons.	Continue rationing access to energy to priority areas. Secure alternative sources and storage for gas through the heating season. Targeted transfers to most vulnerable groups within the existing budget envelope.
Abrupt global slowdown or recession. Global and idiosyncratic risk factors combine to cause a synchronized sharp growth slowdown, with outright recessions in some countries.	Medium	**High.** Recessions in key donor countries reduce or delay disbursement of committed external financing and shifts the financing mix toward less optimal sources (monetary financing, other borrowing on non-concessional terms).	Prioritize spending and seek additional revenue measures. Mobilize domestic financing. Diversify external financing sources and obtain financing on highly concessional terms to the extent possible.

1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

De-anchoring of inflation expectations and stagflation. Supply shocks to food and energy prices sharply increase headline inflation and pass through to core inflation, de-anchoring inflation expectations and triggering a wage-price spiral in tight labor markets. Central banks tighten monetary policy more than envisaged leading to weaker global demand, currency depreciations in EMDEs, and sovereign defaults. Together, this could lead to the onset of stagflation.	**Medium**	**Medium.** A tightening of monetary policy in advanced economies increases borrowing costs and raises depreciation pressures and further weakens risk sentiment.	Maintain appropriate macroeconomic policies to anchor inflation expectations. Diversify external financing sources.
		Domestic risks	
Social unrest.	**Medium**	**High.** Rising inflation, declining real incomes, and worsening inequality amplify social unrest and political instability, resulting in counterproductive populist policies that widen fiscal and external imbalances, delay adjustment, and stall reform momentum.	Maintain appropriate macroeconomic policies to safeguard stability. Targeted transfers to most vulnerable groups within the existing budget envelope.
Loss of reform momentum.	**Medium**	**High.** Poor governance, corruption, retrenchment of oligarchic interests, and lack of oversight on the use of external funding decreases incentives for reform. Lack of progress on reforms reduces future external financing.	Adhere to governance reforms while maintaining recent progress made in strengthening anti-corruption and judicial institutions. Mobilize domestic financing.
Local Covid-19 outbreaks. Outbreaks in slow-to-vaccinate countries or emergence of more contagious vaccine-resistant variants force new lockdowns or inhibit commerce. This results in extended supply chain disruptions, slower growth, capital outflows, and debt distress in some EMDEs.	**Medium**	**Medium.** In combat zones in particular, new vaccinations are difficult to procure or roll out, health care provision is impaired, and containment measures are difficult to enforce. Logistical issues are further complicated by disruptions to the workforce. Increase in internal/outward migration.	Rationalize nonessential spending and mobilize additional financing to meet additional health expenditures, while providing targeted assistance to most affected groups, as permitted by the budget envelope.

Structural Risks			
Deepening geo-economic fragmentation and geopolitical tensions. Broadening of conflicts and reduced international cooperation accelerate deglobalization, resulting in a reconfiguration of trade, supply disruptions, technological and payments systems fragmentation, rising input costs, financial instability, a fracturing of international monetary and financial system, and lower potential growth.	**High**	**High.** Ukraine remains at the fault line of ongoing geopolitical tensions and is a trade dependent economy exposed to supply chain issues.	Maintain appropriate macroeconomic policies to safeguard stability. Diversify trade products, supply chains and partners. Continue with reforms to support competitiveness and increase productivity.
Cyberthreats. Cyberattacks on critical physical or digital infrastructure (including digital currency platforms) trigger financial instability and disrupt economic activities.	**High**	**High.** Ukraine remains exposed to attacks on critical infrastructure (electricity, heat, and water), while attacks on digital infrastructure can disrupt the banking system and economic activity, particularly given the reliance on non-cash payments during the war.	Strengthen digital infrastructure and cybersecurity. Diversify electricity, energy, and water sources.

Annex II. 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 sufficiently large external financing to address the severe impacts of the war, and if this support comes in the form of grants, highly concessional loans and other exceptional financing.

1. **This DSA updates that which accompanied Ukraine's October 2022 request for IMF emergency financing.** The previous DSA determined that Ukraine's macroeconomic situation was stabilizing after a very large initial war shock, making it possible to present a central scenario for 2022, capturing the impact of that shock on key macroeconomic variables, including GDP growth, the fiscal balance, the exchange rate, borrowing costs, and financing (see IMF Country Report No. 2022/323). The resulting analysis found a substantial step increase in the debt-to-GDP ratio in 2022 and elevated gross financing needs and pointed to very high near-term vulnerabilities amid continuing uncertainty around the timing of external financing disbursements. That said, risks appeared 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 macroeconomic framework supporting this update reflects the recent macroeconomic developments and a revised near-term outlook.** The assumptions under this DSA involve modifications to the outlook for 2022 and 2023.

- **2022 Outlook.** While the war continues to severely impact the economy, activity stabilized somewhat in the third quarter, and the economic contraction for the year is now projected to be 33 percent (35 percent previously). Inflation is high and rising at 26.6 percent y/y through October but still broadly in line with earlier expectations. Disbursed and prospective external official financing has been slightly higher than anticipated in October (around US$33 billion rather than US$ 31.5 billion). Furthermore, the external financing mix has shifted more to grants, which are expected to account for about 43 percent of all financing, 10-percentage point higher than assumed in the last DSA. Nonetheless, given extreme fiscal pressures from defense and social needs, a recently emerged general government financing gap can only be partially closed through domestic market financing, and this DSA assumes a residual gap at end-2022 of UAH 67.7 billion (or US$1.8 billion) that is incorporated into the public debt stock as prospective arrears.

Ukraine: Assumptions for 2022-2023 under RFI (October 2022) and PMB (December 2022)

	2022		2023	
	RFI	PMB	RFI	PMB
Growth (percentage change)	-35.0	-33.0	3.5	1.0
Inflation (GDP deflator; percent)	28.6	28.5	27.3	28.5
Primary deficit (percent of GDP)	16.3	17.1	5.8	3.6
External financing (USD billions)	33.5	32.7	20.1	39.5

- **2023 Outlook.** The central scenario assumes a stabilization of activity in 2023 as the economy adjusts to a protracted war. Ukraine's economy is forecast to grow by 1 percent in 2023 (3.5 percent previously). This forecast reflects the expected impact on activity in 2023Q1 of a weak harvest (mainly due to disruptions of agricultural activity in occupied and combat-affected areas and the availability of inputs), subdued consumer sentiment, and assumes that the authorities can continue to repair the damage from attacks to the energy infrastructure. External financing assumptions have been revised upward relative to the last DSA, i.e., from around US$20 to US$39.5 billion, of which US$18 billion are assumed to come in the form of grants and the balance in the form of concessional loans. This external financing assumption is tentative as donors financing commitments are still in the process of being approved, but financing at this level would be consistent with the effective implementation of Ukraine's 2023 budget, an increase in domestic borrowing to cover most redemptions, and the execution of project financing at a similar rate to that in 2022. Downside scenarios would entail significantly higher financing needs.

3. The medium-term forecast for Ukraine is still subject to unusually large and unique uncertainties, as there are several plausible but widely differing scenarios that would yield varying debt and GFN trajectories. As noted in the previous DSA, there are profound uncertainties around the duration and severity of the war, current and future damages, Ukraine's capacity to export goods, the rate at which migrants may return, and the pace at which fiscal policy can be normalized. Conversely, it is premature to incorporate into the macroeconomic outlook firm assumptions on a very large recovery and reconstruction plan, since the design and financing of that plan has yet to agreed, and its timing rests on developments of the war. A scenario explicitly incorporating a reconstruction strategy would entail substantially larger financing and would have a major impact on growth prospects, as well as all the key variables guiding any assessment of Ukraine's forward-looking debt carrying capacity. This DSA retains the tentative and modest medium-term financing assumptions applied under the previous analysis for 2024 and beyond and makes no assumptions on recovery and reconstruction.

4. The impact of the war thus far, coupled with the above 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.

5. 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 central scenario 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 on a single central scenario, whereas a case can be made for other plausible scenarios for Ukraine, leading to a range of signals. Further, these simulations are mainly informed by historical observations, ignoring the major structural break posed by the war shock, and so they may be less informative. Finally, long-term modules are still omitted given projection uncertainties, which could leave out important information (such as reconstruction). These caveats aside, the DSA continues to clearly highlight the need for large-scale financial support to address the severe impacts of the war, and that this be in the form of highly concessional loans, grants, 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.

Table 1. Ukraine: Risk of Sovereign Stress

Horizon	Final assessment	Comments
Overall	**High**	The overall risk of sovereign stress is high, reflecting high vulnerabilities in the medium-term horizon.
Near term 1/	n.a.	Not applicable.
Medium term	**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 the financeability tool finds high liquidity risks compared to relevant comparators.
Fanchart	…	
GFN	…	
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/	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.

Table 2. Ukraine: Debt Coverage and Disclosures

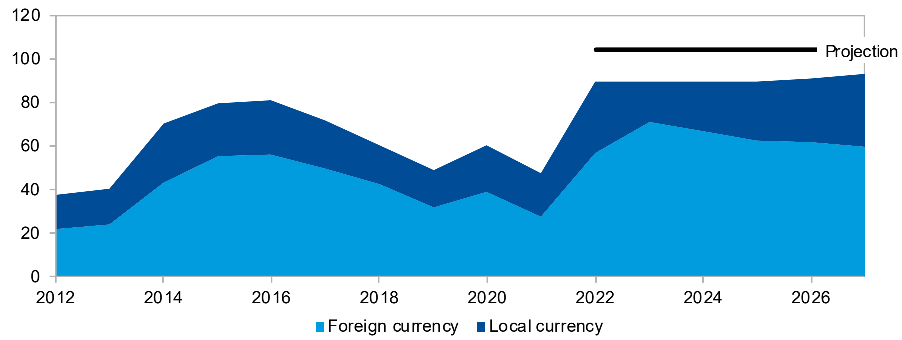
							Comments
1. Debt coverage in the DSA: 1/		CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?						n.a.	
2. Subsectors included in the chosen coverage in (1) above:							
	Subsectors captured in the baseline					Inclusion	
CPS / NFPS / GG: expected / CG	1 Budgetary central government					Yes	
	2 Extra budgetary funds (EBFs)					No	Not applicable
	3 Social security funds (SSFs)					Yes	
	4 State governments					Yes	
	5 Local governments					Yes	
	6 Public nonfinancial corporations					Yes	
	7 Central bank					Yes	
	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.

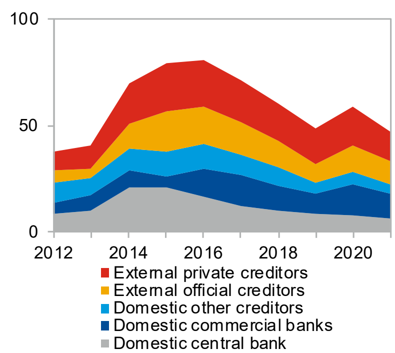
Figure 1. Ukraine: Public Debt Structure Indicators

Debt By Currency (percent of GDP)



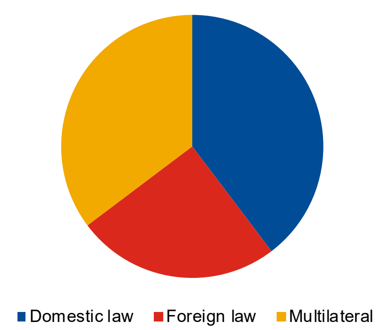
Note: The perimeter show n is general government.

Public debt by holder (percent of GDP)



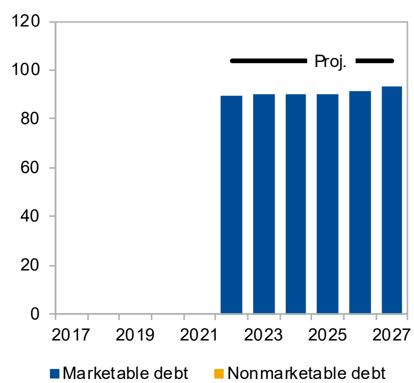
Note: The perimeter show n is general government.

Public debt by governing law, June 2022 (%)



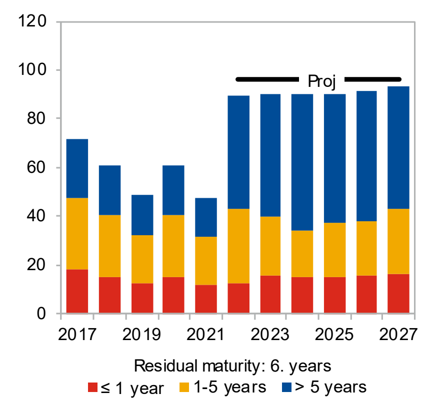
Note: The perimeter show n is general government.

Debt by instruments (percent of GDP)



Note: The perimeter show n is general government.

Public debt by maturity (percent of GDP)



Note: The perimeter show n is general government.

Commentary: This DSA does not anticipate major forw ard-looking changes in the composition of debt by currency. Data on the debt structure situation is available for end-June 2022, w hich 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.

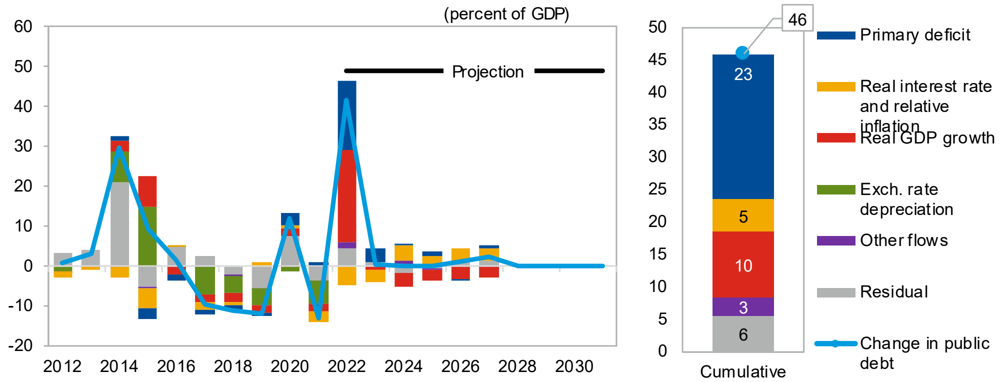
Table 3. Ukraine: Baseline Scenario

(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	89.4	89.9	89.8	89.9	91.1	93.5	n.a.	n.a.	n.a.	n.a.
Change in public debt	-13.0	41.8	0.5	-0.1	0.1	1.2	2.4	n.a.	n.a.	n.a.	n.a.
Contribution of identified flows	-9.4	37.4	-0.4	1.7	0.8	-0.2	1.1	n.a.	n.a.	n.a.	n.a.
Primary deficit	1.1	17.1	3.6	0.1	1.3	-0.2	0.6	0.0	0.0	0.0	0.0
Noninterest revenues	36.3	55.4	47.5	44.3	41.5	42.5	44.9	0.0	0.0	0.0	0.0
Noninterest expenditures	37.4	72.6	51.0	44.4	42.8	42.3	45.5	0.0	0.0	0.0	0.0
Automatic debt dynamics	-10.4	18.8	-3.9	0.0	-0.5	0.0	0.6	n.a.	n.a.	n.a.	n.a.
Real interest rate and relative inflation	-2.7	-4.6	-3.0	3.5	2.5	3.2	3.2	n.a.	n.a.	n.a.	n.a.
Real interest rate	-9.0	-12.7	-14.2	-3.9	-2.3	0.8	1.5	n.a.	n.a.	n.a.	n.a.
Relative inflation	6.3	8.1	11.2	7.4	4.8	2.4	1.7	n.a.	n.a.	n.a.	n.a.
Real growth rate	-2.0	23.4	-0.9	-3.5	-3.0	-3.2	-2.7	n.a.	n.a.	n.a.	n.a.
Real exchange rate	-5.8	...	...	...	...	...	...	...	...	...	...
Other identified flows	-0.1	1.4	-0.1	1.6	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0
Contingent liabilities	0.0	0.0	0.0	1.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other transactions	-0.1	1.4	-0.1	-0.1	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0
Contribution of residual	-3.5	4.4	0.9	-1.8	-0.7	1.4	1.3	n.a.	n.a.	n.a.	n.a.
Gross financing needs	5.9	30.5	18.9	22.5	19.2	18.5	20.3	n.a.	n.a.	n.a.	n.a.
of which: debt service	4.8	13.4	15.4	20.7	17.9	18.7	19.7	n.a.	n.a.	n.a.	n.a.
Local currency	n.a.	8.6	11.8	12.4	11.3	12.5	12.8	n.a.	n.a.	n.a.	n.a.
Foreign currency	n.a.	4.8	3.6	8.3	6.6	6.2	6.9	n.a.	n.a.	n.a.	n.a.
Memo:											
Real GDP growth (percent)	3.4	-33.0	1.0	4.0	3.4	3.6	3.0	n.a.	n.a.	n.a.	n.a.
Inflation (GDP deflator; percent)	25.1	28.5	28.5	15.1	10.6	6.3	5.0	n.a.	n.a.	n.a.	n.a.
Nominal GDP growth (percent)	29.3	-13.9	29.8	19.7	14.4	10.2	8.2	n.a.	n.a.	n.a.	n.a.
Effective interest rate (percent)	5.9	5.5	7.9	9.9	7.7	7.3	6.8	n.a.	n.a.	n.a.	n.a.

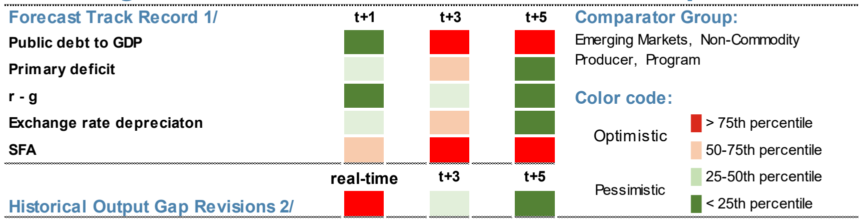
Contribution to change in public debt

(percent of GDP)

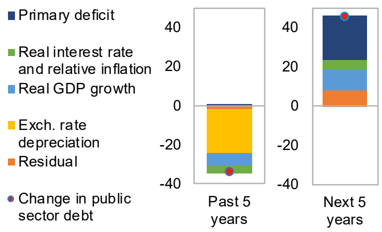


Commentary: The war leads to a step rise in Ukraine's debt-to-GDP ratio. Forward-looking assumptions are highly tentative. The DSA assumes war impacts declining, and front-loaded, concessional financial support through 2024. Debt service assumptions include the August 2022 debt service standstill agreed 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 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.

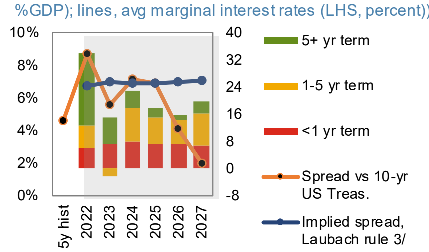
Figure 2. Ukraine: Realism of Baseline Assumptions



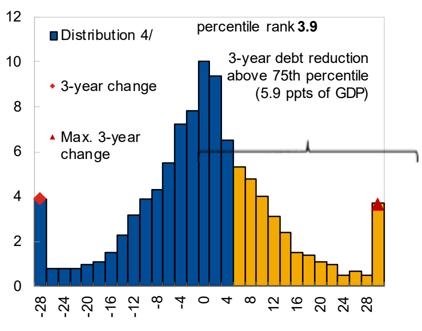
Public Debt Creating Flows
(Percent of GDP)



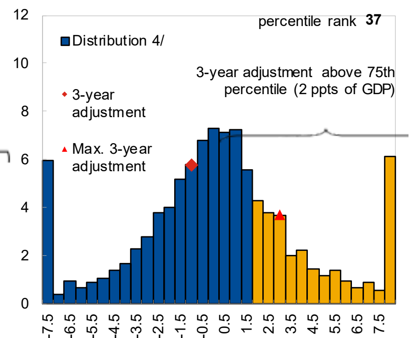
Bond Issuances (bars, debt issuances (RHS, %GDP); lines, avg marginal interest rates (LHS, percent))



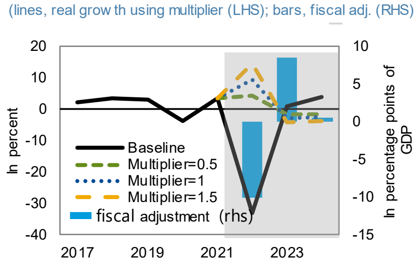
3-Year Debt Reduction
(Percent of GDP)



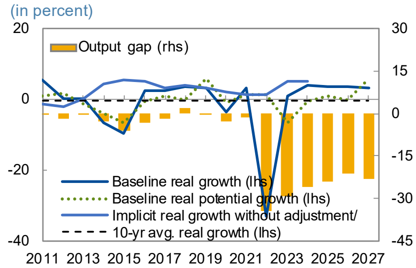
3-Year Adjustment in Cyclically-Adjusted Primary Balance (percent of GDP)



Fiscal Adjustment and Possible Growth Paths
(lines, real growth using multiplier (LHS); bars, fiscal adj. (RHS)



Real GDP Growth
(in percent)



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/ 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.

4/ 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.

Figure 3. Ukraine: Medium-Term Risk Analysis

Debt Fanchart and GFN Financeability Indexes

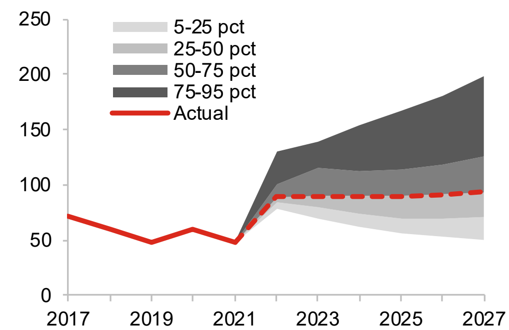
(percent of GDP unless otherwise indicated)

Module	Indicator	Value	Risk index	Risk signal
Debt fanchart module	Fanchart width	148.0	2.1	…
	Probability of debt not stabilizing (pct)	71.2	0.6	…
	Terminal debt level x institutions index	63.7	1.4	…
	Debt fanchart index	**…**	**4.1**	**High**
GFN finance-ability module	Average GFN in baseline	21.7	7.4	…
	Bank claims on government (pct bank assets)	27.3	8.8	…
	Chg. in claims on govt. in stress (pct bank assets)	80.2	26.8	…
	GFN financeability index	**…**	**43.0**	**High**

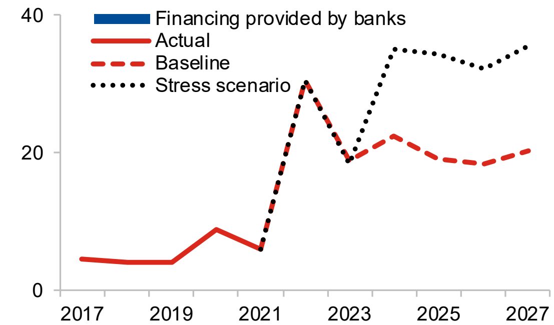
Adv. Econ., Non-Com. Exp, Program: 0, 25, 50, 75, 100

Legend: Interquartile range; Ukraine

Final fanchart (pct of GDP)



Gross Financing Needs (pct of GDP)

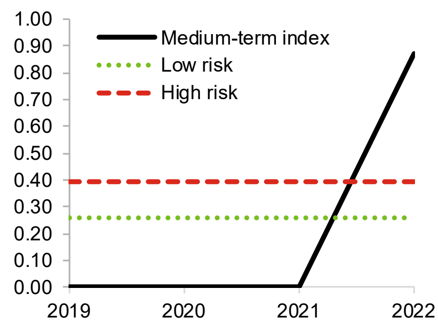


Triggered stress tests (stress tests not activated in gray)

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	0.8
Medium-term index (MTI)	0.3	0.4	…	0.9, 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 December 8, 2022
Managing Director
International Monetary Fund
Washington, D.C., 20431
U.S.A.

Dear Ms. Georgieva:

1. Russia's illegal and unjustified invasion of our country continues to bring enormous human, social, and economic costs. The war has caused large loss of life and the migration and internal displacement of over 14 million people. Unemployment has risen, real incomes have declined, and the poverty rate has climbed to over 20 percent. It has led to the widespread destruction of physical capital, significant logistical challenges, and disruptions to our pivotal agricultural and metal sectors. Recent attacks on our critical energy infrastructure are also threatening the population's access to basic needs (electricity, heating, water, and sewage) ahead of the winter season.

2. In spite of this unprecedented shock, we have successfully kept core government institutions and services functioning, while also maintaining macroeconomic and financial stability. Payment systems and online banking services continue to function normally, and banks' branches remain operational in most areas. Upon the outbreak of the war, we enacted emergency policy measures to support macroeconomic and financial stability and prioritize resources toward the war effort. These included fixing the exchange rate, applying regulatory forbearance in the financial sector, and introducing tax relief measures. As the economy adjusts to the war environment, we have continued to adjust our monetary and FX policy toolkit with the aim of safeguarding price and exchange rate stability and protecting FX reserves.

3. Large external bilateral and multilateral financial support provided to our country has also been critical to maintaining stability. In this regard, we are grateful for the support provided by the IMF this year. The two disbursements totaling about US$2.7 billion under the Rapid Financing Instrument, together with the additional US$2.2 billion that were channeled to Ukraine through the IMF Administered Account to date, have provided much needed budget support at a time of acute stress.

4. However, we continue to face tremendous challenges and our financing needs remain very large and subject to significant risks. A critical issue remains the scale, intensity, and duration of the war, and its impact on physical infrastructure, labor supply, human capital, purchasing power, and poverty. A further escalation by Russia, involving more damage to critical infrastructure, would magnify fiscal and BOP gaps through increased import needs, weigh on sentiment, and accelerate outward migration.

5. Against this background, we have requested a 4-month Program Monitoring with Board Involvement (PMB) to provide an anchor for near-term macroeconomic stabilization and build a strong track-record of policy implementation. The PMB will also provide a robust macroeconomic framework to assess external financing needs, thereby serving as a crucial avenue to catalyze international financial support. The principal objective of our economic policies under the PMB is to ensure adequate resources for core functions of the state, while safeguarding near-term macroeconomic and financial stability. The key policy areas and commitments to achieve this objective, which are laid out in detail in the attached Memorandum of Economic and Financial Policies (MEFP) include:

- On the fiscal side: increasing tax revenues to create room for better protecting social spending and critical capital expenditures. With the help of Technical Assistance from the IMF, we will develop (i) a roadmap of tax policy and administration measures (MEFP ¶15) and (ii) a concept note laying out our initial thinking on how to approach future social safety net reforms while safeguarding fiscal sustainability (MEFP ¶17), and (iii) we will also take steps to prevent and clear arrears (MEFP ¶12).

- An important policy objective is to shift toward a domestic financing mix that better supports macrofinancial stability with the aim of eliminating reliance on monetary financing in 2023. Together with external financing, this will require implementing measures to better mobilize financing through the domestic bond market (MEFP ¶25).

- Monetary and exchange rate policies will continue to focus on safeguarding price and external stability. The NBU will continue to implement appropriate measures to help manage liquidity and improve monetary transmission.

- Updating our financial sector strategy to safely unwind financial sector emergency measures and restore accounting and prudential norms. In the near term, we will prepare, in consultation with IMF staff, a Terms of Reference for bank diagnostics (MEFP ¶36).

- Strengthening transparency and governance. In particular, we will renew efforts toward good corporate governance practices in state-owned enterprises and banks, protect the independence of their supervisory boards, and preserve independent, competent, and trustworthy anti-corruption institutions.

6. We will continue to collaborate closely with the IMF when designing and implementing policy measures, and we will consult with IMF staff on our draft legislative proposals with material implications for economic and financial policies before we present them to the Parliament, as well as on any potential revisions to the policies contained in the MEFP. We are determined to preserve the hard-won gains from past Fund-supported programs and will refrain from policies that would be inconsistent with the program's objectives. In that regard, we intend to continue protecting the tax base from any further erosion and we remain strongly committed to safeguarding NBU independence.

7. We will provide IMF staff with the data and information it needs for the purpose of program monitoring, including by adhering to the data provision requirements described in the attached Memorandum of Technical Understanding (TMU). We will also resume the provision of data critical to macroeconomic and financial surveillance as agreed with IMF staff.

8. 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 circumstances eventually normalize, in consultation with IMF staff.

9. The program will be monitored through one review based on an end-December 2022 test date and structural benchmarks. Table 1 of the attached MEFP presents the quantitative targets and Table 2 describes the structural benchmarks under the program. The March 2023 indicative targets will help guide our program implementation at the start of next year.

10. We expect that strong performance and appropriate data provision under the PMB will build a track record that would help facilitate the transition to a potential IMF Upper-Credit Tranche arrangement in 2023.

11. We consent to the IMF's publication of this letter, the MEFP, the TMU, and the accompanying Executive Board documents.

Sincerely yours,

/s /

Volodymyr Zelenskyy
President of Ukraine

/s /

Denys Shmyhal
Prime Minister of Ukraine

/s /

Sergii Marchenko
Minister of Finance of Ukraine

/s /

Andriy Pyshnyy
Governor, National Bank of Ukraine

Attachment I. Memorandum of Economic and Financial Policies

December 8, 2022

1. Russia's illegal and unjustified invasion of our country continues to bring enormous human, social, and economic costs. Russia's war of aggression has caused large loss of life and, according to the UNHCR, the migration and internal displacement of over 14 million people, over a third of our population. It has led to the widespread destruction of physical capital, including homes, roads and bridges, schools, hospitals, and factories, and brought forth significant logistical challenges, including loss of access to our seaports. The war has disrupted our pivotal agricultural sector, with dire consequences for Ukraine and the rest of the world, and destroyed capacity in our metals sector. Unemployment has risen, real incomes have declined, and as estimated by the World Bank, over 20 percent of our population has been plunged into poverty, threatening a dramatic loss in the living standards we have strived so hard to achieve since independence. More recently, attacks on our critical energy infrastructure, which have impacted more than 40 percent of our power grid, are hampering the population's access to basic needs (electricity, heating, water and sewage) ahead of the winter season. Each additional day of the war brings fresh damage to our economy, and the reconstruction costs will be enormous.

2. In the face of this unprecedented shock, we have successfully kept core government institutions functioning, while also maintaining macroeconomic and financial stability. Despite very difficult circumstances, government services have continued functioning, including revenue administration, the court system, law enforcement, and the anticorruption institutions. Payment systems and online banking services continue to function normally, and banks' branches remain operational in most areas. Upon the outbreak of the war, we enacted emergency policy measures to support macroeconomic and financial stability and prioritize resources toward the war effort. These included fixing the exchange rate, imposing FX restrictions, applying regulatory forbearance in the financial sector, and introducing tax relief measures. We sought and agreed upon debt service suspension on our Eurobonds (through August 2024) and bilateral debt (until end-2023) to preserve our scarce resources.

3. However, as the war continues, economic policy challenges persist. Public finances remain under immense pressure, with rapidly increasing expenditures (mainly for security and defense and social spending) and weak revenues leading to an unprecedented fiscal deficit. Despite sizable external official financing inflows, and amid lack of international market access, we have been forced to finance a sizable part of this deficit with monetary financing, presenting risks to macroeconomic and external stability. At the same time, inflation remains elevated due mainly to war-related supply disruptions. There are continuing imbalances in the FX market, as export proceeds are curtailed while FX demand remains steady, including for essential imports such as fuel and equipment and for deposit withdrawals by Ukrainian migrants living abroad. This imbalance has been straining our FX reserves and has led to periodic pressure on the exchange rate.

4. We firmly believe that strong implementation under the Program Monitoring with Board Involvement (PMB) will provide a clear anchor for near-term macroeconomic stabilization while catalyzing donor financing, help pave the way for an Upper-Credit Tranche facility, and thus help us navigate this very challenging period. Under the 4-month PMB, the principal objective of our economic policies is to safeguard near-term macroeconomic stability, including by increasing revenues and mobilizing domestic financing of the fiscal deficit to minimize monetary financing, while undertaking contingency planning in view of the prevailing uncertainty. The PMB will also provide a robust macroeconomic framework to strengthen internal coordination as well as help identify and communicate financing needs to external partners, thereby serving as a crucial avenue to harmonize and catalyze international financial support. We have requested a 4-month PMB.

5. We remain fully committed to implementing sound economic policies and to preserving the hard-won gains from past Fund-supported programs. We are committed to full program ownership and coordination across all relevant agencies toward this objective. We will consult with IMF staff on our draft legislative proposals with material implications for economic and financial policies before we present them to the Parliament. We are also committed to continue strengthening transparency and accountability, which will be important to sustain donor support. We also intend to continue protecting the tax base from any further erosion and to uphold recent governance reforms in state-owned enterprises, state-owned banks, and anti-corruption institutions. We reiterate our commitment to safeguarding NBU independence.

A. Economic Outlook

6. We expect economic activity to stabilize in 2023, although the outlook depends critically on the duration and intensity of the war.

- Following a drop by nearly a third in 2022, **real GDP** could rise modestly by about 1 percent in 2023, assuming a gradual strengthening of activity in areas not under active combat, continued access to the grain corridor, and no further escalation of the war. The slow recovery reflects the persisting impact of the recent damage to energy infrastructure into the first quarter of the year. Activity is expected to pick up in subsequent quarters, supported mainly by government spending, while the recovery in exports is expected to be only gradual (in view of the destruction to capacity and residual logistical bottlenecks), and consumption growth is expected to remain weak (mainly on account of the decline in purchasing power).

- **Inflation** is expected to moderate from 30 percent y/y in end 2022 to about 22.5 percent y/y at end-2023, reflecting the residual effects of supply disruptions and destruction of production facilities, amid an environment of softer global energy prices.

- The **current account** is expected to move to a deficit of around US$5.7 billion in 2023, following a projected surplus of US$6.4 billion in 2022. This reflects a widening in the trade balance, as the recovery in export proceeds is expected to be slow, while import demand is expected to accelerate, due to continued demand for fuel, equipment, and materials for repair and rehabilitation. Sizable external financing inflows should support FX reserves levels of around US$21 billion by end-2023, equivalent to 2.5 months of imports.

7. **The economy could rebound more quickly if the security and infrastructure situation improve more quickly than expected.** The economy could register a much stronger recovery should there be a faster than expected decline in security risks and a swifter resolution of the ongoing challenges to energy and logistical infrastructure. Under such assumptions, growth in 2023 could strengthen to 3-4 percent. The outlook could be further boosted a quicker return of migrants as well as through a large-scale reconstruction effort that accelerates the recovery.

8. **Nevertheless, uncertainty is high, and risks to the outlook are tilted to the downside, with implications for our external financing needs.** The recovery in economic activity in 2023 could be much slower than expected. In particular, the recovery could be weaker should the impact of the recent attacks on critical infrastructure persist for longer than expected, the security situation deteriorate, the grain corridor shut down, or outward migration accelerate. In such scenarios, our external financing needs could be markedly higher.

B. Fiscal Policy

9. **From the onset of the war, we have taken measures to preserve macro-financial stability, including emergency measures aimed at protecting core government operations, and priority payments.** Following the adoption of Martial Law on February 24, 2022, we have prioritized spending on public wages, defense, social protection and other critical needs, given immediate liquidity constraints. At the same time, under Martial Law we undertook measures on the tax front to provide relief, including a reduction in tax rates, deferrals of payments for those unable to pay, relaxation of administrative requirements, and a move to simplified taxation for certain brackets. We remained current on all our external and domestic debt obligations until debt standstills were agreed upon with private and bilateral creditors in August and September 2022, respectively.

10. **As the war has continued, public finances have come under severe pressure.** Revenues have weakened due to the contraction of the economy and relief measures while expenditures have grown at a rapid pace due to security and defense and social spending. As a result, the nine-month cumulative general government fiscal deficit measured below the line, for 2022 is estimated at UAH 406.6 billion or 8.7 percent of 2022 GDP, supported by substantial external grants UAH 342.5 billion or 7.3 percent of 2022 GDP; the cumulative deficit excluding grants is UAH 749.1 billion (15.9 percent of GDP). The deficit has been financed primarily by external official financing and NBU monetary financing, whereas net financing from domestic banks and non-banks turned negative. In line with our objective of strengthening public finances, to monitor our progress in this area, a floor on the non-defense cash primary balance of the general government (excluding grants) **(*Quantitative Target, end-December 2022; Indicative Target, end-March 2023*)** and a floor on

the overall cash primary balance of the general government (excluding grants) **(*Indicative Target, end-December 2022 and end-March 2023*)** will be introduced.

11. Despite large-scale and extraordinary support from the international community, and our effort to keep public finances under control, we face a financing gap for the remainder of 2022. In these times of unprecedented uncertainty, we have been moving to realign our financing sources and spending needs on a monthly basis, reflected in several supplementary budgets adopted throughout 2022. The last supplementary budget approved by the Rada on October 18 increased the spending envelope by UAH 386.9 billion, for security and defense sector which includes current expenditures in the amount UAH 385.2 billion (including wages with accruals of UAH 232.7 billion) and capital expenditures (about UAH 1.7 billion). This, combined with uneven disbursements of committed external financing, has increased the financing gap for 2022.

12. We are identifying measures to close this financing gap, and will take steps to monitor, avoid and control arrears. Closing the gap without additional external resources will be extremely difficult. We will ensure financing for priority expenditures for 2022, drawing on resources from the Treasury Single Account as well as additional domestic borrowing, while identifying spending categories that can be underexecuted. Further measures would be required to fully close the gap, especially if additional shocks occur. Following this exercise, we will establish the level of arrears for state budget and social funds for end-2022, consistent with the national definition of overdue financial obligations, which would encompass any carryover from 2022 to the 2023 Budget. We will ensure monitoring of payment arrears across the general government consistent with the national legal definition of overdue financial obligations. To support these goals, we will develop an action plan to prevent and clear arrears over the course of the 2023 Budget and beyond **(*Structural Benchmark, end-January 2023*)**.

Fiscal Policy in 2023

13. Our 2023 Budget aims to achieve wartime spending goals while sustaining macroeconomic stability and preparing for the post-war era. Although the spending envelope is currently focused on defense and security, to the extent possible we have safeguarded resources for the social safety net and rebuilding damaged infrastructure by prioritizing capital expenditures. The deficit excluding external grants in the 2023 Budget (prepared amidst preliminary discussions on external financing next year), is projected at UAH 1,316.4 billion, or about 21.6 percent of GDP. This is 8.7 percentage points of GDP lower than the estimated 30.3 percent of GDP deficit excluding external grants for 2022.

14. Our budget projections for tax revenue reflect the impact of the war and slow economic recovery. We expect taxes on income will deteriorate, reflecting the deteriorated profit base of companies and the continued destruction to economic capacity; structural developments in the labor market; and a decline in the public sector wage bill. Taxes on goods and services are projected to improve somewhat as consumption recovers (from a low base) and measures under Martial law are lifted. We have already incorporated in the 2023 Budget about 0.6 percent of GDP in revenue measures and adopted a timeline to restore excise and VAT on fuel toward pre-war policies from July 2023. The revenues from natural resource taxation (e.g., royalties) are expected to decline due to the continuing impact of war and volatility in prices. We acknowledge that the destruction of critical energy infrastructure by Russian missile attacks have led to urgent needs for imports of special equipment for electricity generation and distribution and heating supply, including generators, batteries, and transformers. To address these needs, we have decided to exempt such equipment from import VAT and duties, with generators exempt until March 1, 2023, and transformers and heavy equipment until the end of the Martial Law. The impact on revenues of the approved budget is estimated at UAH 0.3 billion.

15. We are committed to identifying additional revenue sources. With the help of Technical Assistance from the IMF, we will work on developing an integrated roadmap of tax policy and administration measures restoring in the short-term tax administration and policies to their pre-war setup. In the very near term, this will include submission of the following three draft laws to Parliament **(*Structural Benchmark, end-January 2023*)**: (i) on cancelling the moratoria on tax audits (effective July 1, 2023); (ii) on removing idiosyncrasies of the application of the simplified tax regime by taxpayers under the single tax of 2 percent, and restoring the pre-war regime for these taxpayers (effective 1 July, 2023); and, (iii) on ensuring full-scale enforcement of the usage of cash registers in retail outlets (and associated settlement and payment infrastructure), including restoring liability for violations (effective July 1, 2023). In addition, we are working to implement the automatic exchange of information for taxation purposes (Common Reporting Standard (CRS)) and intend to propose necessary legislation. The estimated revenue gains in 2023 from the reversal of the simplified tax regime is assessed at about 0.13 percent of GDP for 2023. We also remain committed to working on the broader design of tax policies and measures for building a modernized revenue administration (including among other things limiting the possibility for PIT tax evasion from using simplified tax regime by group 3 taxpayers) that would help us to achieve our fiscal policy goals in the post-war environment.

16. On the expenditure side, the challenges arising from the war have forced us to take difficult political decisions. First, the spending envelope necessarily focuses on defense and security, requiring an even greater effort to strengthen the efficiency of spending and contain fiscal risks. At the same time, there are increasing pressures from emerging war-related spending categories, including social assistance to IDPs and war veterans, and reconstruction and elimination of the consequences of Russian aggression. In view of the constraints we face, we took the difficult political decision to cut the total compensation envelope of employees in the budget sector by 27 percent in nominal terms relative to 2022, through both cuts in wages of individual categories as well as headcount limitations. Likewise, we capped social benefits, allowing only rule-based pension indexation.

17. We intend to protect the current level of social assistance for the most vulnerable groups in our population. The war has resulted in the emergence of new vulnerable groups of population (e.g., IDPs, war veterans), whose needs should be factored into future reforms of the social assistance framework. With this in mind, we will prepare a concept note that would lay out our thinking on how to approach reforms of the social safety net—with the aim to achieve targeted, adequate, and efficiently delivered social assistance to the population, including the needs of these emerging categories ***(Structural Benchmark, end-January 2023)***. Safeguarding fiscal sustainability will be a key pillar of the concept note. We also intend to work on a medium-term strategy to transition the current wage bill framework that has a significant defense and security component to a peace-time wage bill framework.

18. We commit to provide adequate support to state-owned enterprises (SOEs) in the energy sector and district heating companies (DHCs). The war has compounded existing structural weaknesses in the energy sector. We are committed to implementing an ambitious structural reform agenda once the war is over. In the meantime, in this exceptional context, we are focusing our policies on crisis management.

- Given the damage to critical energy infrastructure, an important near-term focus is on assessing damage, repairing, and ensuring a basic level of service delivery where feasible. The National Energy and Utilities Regulatory Commission (NEURC) is currently considering a Transmission System Operator (TSO) tariff increase that could provide additional resources to Ukrenergo. If further resources would be needed for urgent repairs, we will ensure adequate financial support to Ukrenergo.

- The need to import at least 2 bcm of gas in the coming months to support the heating season and cover the increased use of gas in the electricity generation mix is putting pressure on Naftogaz finances. We are already providing implicit financial support to Naftogaz in the form of reduced gas royalties and will compensate the group for its public service obligations (PSO). In a downside scenario where larger volumes of imports would be required; we will ensure adequate sources of financing can be mobilized.

- Finally, restoring the financial health of the gas transmission system operator (GTSO) will primarily require right sizing the system and identifying new gas supply sources. In the interim, liquidity support may be required.

19. We have established a special fund within the state budget to channel resources for critical expenditure. The Fund for Liquidation of Consequences of the Russian Aggression will be used for reconstruction, including repairing damaged infrastructure. The budget law states that it will be funded by external financial sources, which have yet to be identified, as well as by the earmarking of 50 percent of profits from the NBU, preliminarily estimated at UAH 35 billion, although we plan to remove the latter provision at the first opportunity. In line with our experience of managing other special funds in state budget, we will ensure sound governance and transparency in the use of this fund’s resources by: (i) preparing clear and transparent selection criteria and procedures for priority spending to be approved by the Cabinet of Ministers of Ukraine (CMU); (ii) including underlying amounts in budget documentation and fiscal reports; (iii) including cash resources in the Treasury Single Account; (iv) establishing safeguards on the use of funds and reporting on them; and, (v) conducting and publishing audits.

Fiscal Structural Reforms

20. Despite tremendous pressures and uncertainty, we are determined to continue improving our public financial management framework. Prior work on public finance management was halted with the inception of the war. In this area, we are committed to continue improving the predictability and credibility of the fiscal framework to better support budget preparation and minimize deviations during the execution phase. With the help of IMF Technical Assistance, efforts would aim at using fiscal risk analysis to inform formulation of macro fiscal aggregates and wider fiscal management. We will also work to develop upside and downside scenarios around our central projection of tax revenues. On the expenditure side, we will work to improve the link between fiscal risks assessment and their impact on spending categories, including risks arising from social funds, contingent liabilities especially PPPs, guarantees and SOEs. To this end, we will also work to enhance the institutional capacity, monitoring and assessment of risks from government guarantees.

21. To enhance further budget processes from planning to procurement and execution, we will take measures to enhance payment discipline. In the near-term, amendments to the legislation will be adopted, to restore the Treasury's authority to collect information essential for relevant categories of financial reporting. Subsequently, we will establish oversight over the budget arrears both on state and local level, as well as Social Security Funds to have a clear view of their stock on a monthly basis, with a clear monitoring mechanism aimed at preventing the accumulation of new arrears. With due consideration of the Martial Law, we will also take measures to settle the existing stock of such obligations in accordance with the requirements of budget legislation in a structured and transparent manner. Overall, we are committed to achieving the maximum transparency in data provision possible under Martial Law around all expenditures and on overdue financial obligations, which is also an important input into efficient treasury cash management and liquidity forecasting. To increase the predictability of available liquidity and reduce the risks of sudden financing pressures, we will continue to improve our cash forecasting and liquidity management in line with the objectives set out in the PFM Reform Strategy for 2022-2025, including through the improved exchange of information with key budget spending units and introduction of relevant analytical IT tools.

22. More broadly, to preserve macroeconomic stability and lay the foundations of a robust fiscal framework, we will (i) avoid any measures that would reduce tax revenues, erode the tax base or undermine the credibility of public finances; (ii) ensure realistic and transparent reflection of SOE dividends; and, (iii) exercise control over overdue tax obligations (including from SOEs and VAT refunds).

C. Budget Financing

23. Amid large and urgent financing needs, our overarching strategy is to secure commitments for a financing mix that supports macroeconomic stability. This financing mix will involve ensuring adequate external financing and making concerted efforts to mobilize domestic bank financing, with the aim of avoiding reliance on monetary financing in 2023.

24. External financing will remain the central pillar of the financing mix. We are very grateful to all our international partners and donors for their crucial support in 2022, in particular the US$23.1 billion in external budget support loans and grants received through October 2022. Given the lack of international market access and our significant financing needs, external financing will remain essential to financing our budget in 2023, and thereby help maintain macroeconomic stability. To facilitate support by our international partners, we will take every effort to continue to communicate our fiscal financing needs in a regular, timely and transparent manner to donors and the IMF to ensure an adequate envelope of external financing, on concessional terms to the extent possible, and to identify additional external needs if they arise. We also commit to collaborating closely with our international partners and undertake the key reforms required under their respective arrangements.

25. As part of this strategy, we will take all necessary measures to create an environment that is supportive of domestic banks maintaining their overall sovereign exposure. Following the outbreak of the war, we continued conducting regular treasury auctions, offering "war bonds" to mobilize financing. Whereas the initial response was encouraging, cumulative net financing by domestic banks has been negative since the war started, with rollover rates declining from over 100 percent in March-May to 22 percent in August-September and picking up to 60 percent in October. The share of government securities in total bank assets thus declined in 2022 relative to end-2021, but it is likely to stabilize and increase in 2023, given weak loan demand and banks' demand for safe assets. Mobilizing domestic financing in the primary market, particularly by banks, will be vital to avoiding monetary financing of the budget deficit. To help achieve a significant increase in rollover rates, we intend to:

- Maximize the issuance of domestic government securities in the primary market, with an objective of covering the redemptions expected in 2023. In order to achieve this, we will implement a mix of actions: first, we commit to adjust the yields on government securities offered on the primary market to match market demand and support price discovery; second, we intend to launch a mechanism to allow banks to fulfill up to fifty percent of reserve requirements by benchmark bonds (see ¶30); and, third, we are undertaking a bank-by-bank analysis to better understand banks' current liquidity and credit risk preferences to support these market discovery efforts in reviving primary market auctions, and with the overall aim that banks maintain their exposure.

- Continue strengthening liquidity forecasting and cash management within the Ministry of Finance to ensure better predictability of financing needs (see ¶21). This would inform the appropriate design and calibration of auctions, thereby avoiding monetary financing of the budget deficit.

26. The availability of adequate external financing coupled with such measures to revive the domestic government bond market will support our goal of strictly limiting direct NBU financing of the state budget this year and eliminate it altogether in 2023. Excessive monetary financing would entail large risks for price and external stability. The NBU, in agreement with the Ministry of Finance, determined that it would keep purchases of domestic government securities at about UAH 30 billion per month, or below UAH 400 billion in 2022, and we expect to stay within this limit. This will be monitored by a ceiling on general government borrowing from the NBU **(*Indicative Target, end-December 2022*)**. In 2023, assuming that external financing commitments are disbursed in a timely manner, domestic government securities are issued on the primary market at sufficient volumes, adequate revenues are mobilized to reduce fiscal financing needs, and no further shocks materialize, we would be in a position to eliminate our reliance on monetary financing by the NBU **(*Indicative Target, end-March 2023*)** (see also ¶33). If there are unexpected critical financing needs or delays in external disbursements, we will first apply market-based tools to borrow additional funds; we will request monetary financing from the NBU only as a last resort.

D. Monetary and Exchange Rate Policies

27. Following the outbreak of the war, we undertook a number of emergency measures with the express aim of safeguarding macroeconomic and financial stability. The inflation targeting regime was suspended and a fixed exchange rate regime was introduced, providing an important nominal anchor to the economy amid unprecedented uncertainty. FX transactions were restricted to conserve international reserves. Following the imposition of Martial Law, and given urgent fiscal financing needs to support the war effort, monetary financing of the state budget was permitted.

28. With the war now protracted, we remain fully committed to safeguarding price and exchange rate stability and protecting international reserves. As the economy adjusts to the war environment, we have continued to adjust our monetary and FX policy toolkit in view of these overarching objectives, while at the same time considering the most urgent needs of our population, including migrants abroad. Although the large war-driven fiscal deficit and the resulting monetary financing has imposed constraints on the design and effectiveness of monetary policy, the objective of the NBU remains to maintain price stability and help preserve the value of hryvnia incomes and savings.

29. We will maintain an appropriate monetary policy stance that will help alleviate price pressures and increase the attractiveness of hryvnia assets. Inflation has risen on account of war related disruptions to supply chains, destruction of production facilities and hryvnia deprecation, amid high global inflation, which have driven an increase in inflation expectations. In June 2022, we raised the key policy rate (KPR) by 1,500 bps from 10 percent to 25 percent in a decisive manner to anchor inflation expectations, increase the attractiveness of hryvnia assets, and ease pressures on international reserves. In this regard:

- In our October MPC, we maintained the KPR at 25 percent, which is appropriate in view of high but stabilizing inflation and inflation expectations, the still incomplete transmission of the June hike, and continued headwinds to economic activity.

- In view of the balance of risks to the outlook for 2023-24, we project to keep the KPR at its current level at least until 2024Q2. Together with other measures (¶31), this should help support exchange rate stability and anchor inflation and inflation expectations. However, there are considerable upside risks to inflation, and we stand ready, should they materialize, to raise the KPR to a higher level and deploy additional measures to maintain price and external stability.

30. We have undertaken measures to manage liquidity, and thereby enhance the monetary policy transmission mechanism. Monetary transmission has been gradual, due to the record amount of hryvnia liquidity in the banking system (nearly UAH 300 billion as of end-October) as well as the slow adjustment of government bonds yields on the primary market and the abundant liquidity in large state-owned banks that has weakened incentives to increase deposit rates.

- To support banking system liquidity, in February, we introduced an emergency unsecured refinancing facility. In April, eligibility for this facility was tightened given ample bank liquidity. As system-wide liquidity continued to rise and the cost of refinancing increased with the KPR hike in June, outstanding amounts of refinancing had dwindled from UAH 161 billion in March to UAH 54.2 billion by end-October (refinancing under the unsecured refinancing facility amounted to UAH 26.1 million by end-October). In view of the record excess liquidity in the system, and dramatically reduced use of refinancing more broadly, we suspended the unsecured facility on November 5.

- We plan to tighten reserve requirements by 5 percentage points on demand deposits in hryvnia and foreign currency. We will also introduce a mechanism that would allow banks to fulfill up to half of their total reserve requirement with benchmark government securities. Of the part that can be fulfilled with government securities, up to 40 percent can consist of existing benchmark securities maturing after 1 January 2024, and the remainder with new benchmark securities offered by the Ministry of Finance in the primary market. The liquidity absorbed through the increase in the reserve requirement ratio (particularly through the part fulfilled through reserves) will tighten liquidity conditions, and thereby support the overall monetary policy stance. In addition, the proposed mechanism, by providing incentives to revive the Ministry of Finance's primary auctions, will help avoid monetary financing of the budget deficit by the NBU, preventing further liquidity injections from this source. We do not envisage this mechanism as being permanent feature of the of our monetary policy toolkit, and after the expiration of Martial Law we will develop a plan to phase it out.

- We are also actively studying the feasibility of other options to manage liquidity. On NBU Certificates of Deposits (CDs), we intend to restore the main operation of CDs from overnight to 14 days at the KPR, as before the war, and to consider issuing CDs with longer maturity to sterilize excessive liquidity; this would allow better control of liquidity conditions and enhance monetary transmission. The infrastructure for the interbank repo/reverse repo market is also in place, which could help banks better manage their liquidity in the period ahead.

- The primary objective of the NBU remains to safeguard price and external stability. We expect that as yields in the primary government debt market necessarily increase with price discovery, higher volumes of domestic financing will help reduce the injection of liquidity from monetary financing. The resulting decline in liquidity, together with the measures outlined above, will enhance the effectiveness of the key policy rate and any further adjustments we make to the monetary policy toolkit, providing the necessary support to other rates in the economy.

- A liquid secondary market for domestic government bonds is an important element of strengthening monetary transmission, while at the same time, it enhances the ability of the government to tap the market to finance its budget needs. In this light, we will continue to support the development of the secondary market. We believe that the mechanism to form a portion of required reserves with benchmark government bonds will improve liquidity in these bonds and encourage greater participation in both the primary and secondary markets.

31. We have taken all necessary measures to manage pressures in the FX market, maintain exchange rate stability and safeguard international reserves. Amid the war-driven imbalances in the FX market, the NBU has become a net seller of FX, with cumulative net sales since February 24 of US$18.5 billion as of end-November. Nevertheless, sizable inflows of external financing, as well as, more recently, FX proceeds from the Black Sea Grain Initiative, have helped contain the loss in FX reserves, with reserves declining from US$30.9 billion in end-2021 to US$25.2 billion as of end-October. The FX restrictions imposed at the beginning of the war have helped to limit pressure on our FX reserves, but on the other hand, have broken the link between the interbank and cash segments of the FX market, generating a spread between the cash and official exchange rates, which has widened periodically. To help balance the FX market while supporting economic activity and defense and humanitarian efforts, support exchange rate stability, and protect reserves, we have undertaken several measures:

- In July, in response to increasing FX market pressures, we undertook a one-step devaluation of the exchange rate peg by 25 percent from USD/UAH 29.2549 to USD/UAH 36.5686.

- We have taken measures to ease pressures on the cash FX market (where there are currently no restrictions on setting exchange rates) by shifting demand to the noncash FX segment. Here, we have allowed cashless foreign currency purchases by individuals for the purpose of making 3-month or longer deposits within a monthly limit, and introduced a new FX-indexed term deposit facility to help households protect hryvnia savings from exchange rate fluctuations. We have also tightened limits on card withdrawals abroad and instituted a ban on P2P payments from hryvnia payment cards (issued by Ukrainian banks) to foreign banks.

- We have taken measures to facilitate humanitarian and defense efforts. We have allowed charitable funds greater flexibility (as compared to other legal entities) on the use of FX balances in their accounts, and allowed the use of FX, including domestically, for crowdfunding purposes.

Individual volunteers are allowed to conduct Swift transfers abroad (within a limit), and to use not only their FX payment cards (no limit) but also hryvnia payment cards abroad (beyond the monthly limit) for the purchase of a predefined set of goods to support the defense effort, where verified and approved by banks. We have finetuned the currency supervision requirements on banks for the import of humanitarian goods following the simplification of the customs procedures related to the imports of such goods.

- We have also adjusted measures to better support the needs of trading firms amid logistical difficulties. After narrowing the settlement deadlines for export and import transactions from 365 days to 90 days following the invasion, we increased the deadlines to 180 days to help them cope with prevailing supply chain disruptions that slow the physical delivery of goods. We have also allowed businesses, under certain limits and conditions, to transfer their available stock of FX cash abroad to support the operations of their foreign units and branches.

These measures aim to strike a balance of supporting economic activity while safeguarding monetary and financial stability. They have together helped reduce the pace of net FX sales by the NBU and narrow the spread between the official peg and the cash rate from nearly 25 percent in mid-July to around 10 percent as of end-November.

32. We will maintain an adequate level of FX reserves to support exchange rate stability and provide a buffer against adverse shocks, given prevailing uncertainty. In 2023, despite a current account deficit, we expect sizable external financing that will help ensure an adequate level of reserves and help keep exchange rate expectations well-anchored. At this point, in view of the continuing imbalances in the FX market, we intend to maintain generally the existing restrictions on FX transactions. However, we will continue to carefully monitor the effectiveness of these measures, and fine tune them in line with the needs of the economy and to limit circumvention. We will also continue to explore measures to further help strengthen the attractiveness of hryvnia assets. Progress in this area will be monitored by a floor on NIR ***(Quantitative Target, end-December 2022; Indicative Target, end-March 2023)*** to ensure an appropriate level of reserves in view of large uncertainty, as well as to support exchange rate stability.

33. Reducing and then eliminating monetary financing will help safeguard price and external stability and safeguard NBU independence. In 2022, despite monetary financing of the state budget amounting to 8 percent of GDP, we have successfully sterilized the associated liquidity injection with FX sales and NBU CDs, keeping nominal base money growth contained at about 12.3 percent y/y as of end-October. In 2023, with the envisioned elimination of monetary financing, we expect base money growth to decline, helping to support inflation deceleration. We will also strive to limit indirect forms of monetary financing that are outside the core functions of the NBU, such as through the directed provision of liquidity to banks or SOEs for the purchase of government securities on the primary market. We will not earmark any NBU profits for specific uses. Direct financing of off-budget programs by the NBU will be avoided altogether.

34. We remain fully committed to upholding the independence and institutional effectiveness of the NBU. A strong and independent NBU remains critical to achieving macroeconomic stability. In this regard, reducing and then eliminating monetary financing of the state budget will be crucial in strengthening NBU's independence (see ¶31). We will also ensure that the distribution of NBU profits to the state budget takes place in line with established procedures in a transparent manner. In November 2022, we also undertook changes to the NBU's organizational structure to better align it with its legal framework and support a more function-based organization model, in line with global best practices and recommendations from past IMF Technical Assistance. We are also committed to undertaking a new safeguards assessment of the NBU in early 2023, for which initial preparations are already underway.

E. Financial Sector

35. We have implemented wide-ranging emergency measures to preserve financial stability and will continue to closely monitor developments and make adjustments as necessary. Banks entered the war well-capitalized and liquid, thanks to the considerable progress achieved in cleaning up the banking system since 2014. Despite the severe impact of the war, almost 90 percent of bank branches have remained operational, online banking services are fully available to all clients with internet connectivity, the non-cash payment system is functioning normally, and liquidity has recovered for most banks. The licenses of four small banks (around 2.8 percent of system assets as of 1 January 2022), two of them Russian state-owned, have been revoked under martial law for reasons mostly unrelated to the economic impact of the war. The financial sector's continued operations is in part due to a number of emergency measures we have taken to preserve financial stability, including:

- Administrative controls were imposed to preserve FX liquidity and channel it towards priority imports;
- An unsecured funding facility was introduced with a maturity of up to one year for an amount up to 30 percent of banks' late-January retail deposits, but it was discontinued on November 5 due to a decline in usage (see ¶30);
- Enforcement actions on banks have been suspended for war-inflicted 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 have been postponed, and regular bank stress testing in 2022 was cancelled;
- Loans restructured during the martial law period are exempt from reclassification for credit risk;
- Banks have been prohibited from related party lending (except for consumer loans granted on standard terms, available to a wide range of borrowers), capital distributions (dividend payments and share buy-backs), and bonus payments; and

- Banks have also granted payment holidays on retail and corporate loans for 3-6 months depending on the type of product and temporarily cancelled fees and commissions on cashless payments as well as cash withdrawals.

36. In anticipation of a return to normality, we will update our financial sector strategy to safely unwind financial sector emergency measures and restore accounting and prudential norms. Our 2021 financial sector development strategy will be updated in consultation with IMF staff and serve as a living document requiring periodic review, modification, and action plans with implementation milestones. Inter alia, the strategy will include: (i) coordinated steps to safely unwind exceptional measures; (ii) diagnostics to identify bank re-capitalization needs and NPL resolution priorities; (iii) a framework to address any capital shortfalls; (iv) a prioritized action plan to monitor and tackle high NPL levels; (v) well-developed contingency plans to respond to potential further shocks; and (vi) coordination arrangements among key stakeholders. In recognition of the importance of well-designed bank diagnostics to the success of the financial sector strategy, the NBU will prepare a Terms of Reference in consultation with IMF staff describing the methodology and processes of bank diagnostics necessary to assess bank capital adequacy and identify NPL resolution priorities **(*Structural Benchmark, end-January 2023*).** The current prohibition on bank capital distributions will remain in place until these diagnostics have been completed. In line with our commitment to financial stability, the Financial Stability Council (FSC) will endorse by end-January 2023 a contingency plan in preparation for potential adverse rulings from the constitutional challenges against the DGF Law and the Bank Resolution Law (Law #590), and update the existing contingency plan, which was prepared at the onset of the last Stand-By Arrangement, in connection with litigation risks over failed banks.

37. We remain committed to strengthening the governance of state-owned banks (SOBs) and recovering value from former shareholders of failed banks. Under previous Fund-supported programs, we have undertaken substantial reforms to improve the governance and oversight of SOBs, including adoption in 2018 of a dedicated SOB framework within the banking law. For each SOB, we have: (i) appointed a majority-independent supervisory board, and (ii) signed a Memorandum of Understanding that defines its relationship with the Cabinet of Ministers of Ukraine as shareholder and to ensure that the SOBs are run on a commercial basis and protected from political interference on operational matters. We also reconfirm our commitment to continue efforts to recover value from assets of failed banks.

38. We remain fully committed to the independence of SOB supervisory boards. We recognize that upholding the spirit of governance reforms in SOBs is key to preserve financial stability, protect public finances, and maintain the confidence of our international partners. We are committed to ensuring that selected supervisory board members are genuinely independent and that the supervisory boards operate free from political pressure. We recently initiated a new recruitment process for independent supervisory board members and have appointed recruitment firms for each SOB. Our aim is to select members by end-February 2023. We will continue to adhere to the established processes for filling vacancies and will offer market-based remuneration to attract and motivate highly qualified Ukrainian and international professionals. We will ensure that operational continuity and institutional memory are preserved at each SOB. To that end and in line with the rules, preference will be given to existing independent board members under equal conditions. The NBU will rigorously apply its fit and proper assessment framework.

F. Governance, Anti-Corruption, and Transparency

39. We reiterate our strong belief in the importance of sound corporate governance in SOEs. We will ensure that SOEs operate at arm's length from the government, including by maintaining majority-independent supervisory boards. We will continue our efforts to strengthen corporate governance in SOEs. A new Law on Joint-Stock Companies improving Ukraine's corporate governance framework was recently approved, and a law on corporatization of Energoatom has passed the first reading in the Rada. We commit to appoint and make fully operational the supervisory board of Naftogaz by end-January 2023, based on transparent and competitive selection procedures **(*Structural Benchmark*).** Finally, we will refrain from any decision that would undermine the corporate governance framework as well as governance in key SOEs, including in the energy sector.

40. We remain firmly committed to preserving independent, competent and trustworthy institutions to combat high-level corruption. Despite the war, efforts by the National Anti-Corruption Bureau of Ukraine (NABU), Specialized Anti-Corruption Prosecutor's Office (SAPO) and the High Anti-Corruption Court to investigate, prosecute and adjudicate corruption have continued unabated. New investigations and cases against senior public officials have been filed and pursued. In July 2022, a new SAPO head was appointed. To support the future work of the new SAPO head, we will reinforce the office with the onboarding of eight new and budgeted SAPO prosecutors by end-December 2022. The work of the selection commission for the new NABU head, which includes independent experts with international experience, is advancing. Consistent with the November 2021 legal amendments, the Cabinet of Ministers is expected to appoint the new head by end-March 2023, following an open, transparent and competitive selection process. The Ethics Council is also continuing with the vetting of candidates to fill all the vacancies in the High Council of Justice (Ukraine's highest judicial self-governance body responsible for judicial appointments and discipline).

41. We will ensure that our strategy for post-war reconstruction meets the highest standards of transparency and accountability. To achieve this goal in terms of usage of funds, we plan to take full advantage of digital technologies, and will coordinate with international partners and civil society organizations to design a platform that will provide timely information so we can transparently track and analyze reconstruction-related procurement processes and expenditures. Our reconstruction strategy will also involve establishing mechanisms to prevent and identify corruption risks, and escalate cases, as appropriate, for investigation by the anti-corruption institutions. Comprehensive audits of the use of reconstruction funds, performance audits of selected individual projects (including project costs, deliverables and outputs), and timely publication of audit reports will also be key features of our strategy.

G. Program Implementation and Monitoring

42. The PMB will have one review based on end-December 2022 test dates. Implementation of the policies under the program will be monitored through five structural benchmarks (SBs) as set out in Table 1, as well as two quantitative targets (QTs) and two indicative targets (ITs) as set out in Table 2. Indicative targets for end-March 2023 will help guide our program implementation at the start of next year.

43. To facilitate monitoring of program targets and commitments under the MEFP, we will adhere to data provision requirements as described in the attached Technical Memorandum of Understanding (TMU). The TMU defines the quantitative and indicative targets under the program, and specifies the data to be shared with IMF staff. On the fiscal front this includes information on critical expenditure categories and overdue financial obligations (including wage bill, social spending categories, deferred payments, arrears in both revenues and expenditures, guarantees, quantified main fiscal risks, including PPPs and social funds). Also, in line with the move toward normalizing economic policies, we will resume the provision of data critical to macroeconomic and financial surveillance as agreed with IMF staff.

Table 1. Ukraine: Structural Benchmarks

	Structural Benchmark	Sector	Timing
1	Develop an action plan to prevent and clear arrears over the course of the 2023 Budget and beyond.	Fiscal	End-January 2023
2	To support efforts to enhance tax revenues, submit to Parliament three draft laws: (i) on cancelling the moratoria on tax audits (effective July 1, 2023); (ii) on removing idiosyncrasies of the application of the simplified tax regime by taxpayers under the single tax of 2 percent, and restoring the pre-war regime for these taxpayers (effective 1 July, 2023); and, (iii) on ensuring full-scale enforcement of the usage of cash registers in retail outlets (and associated settlement and payment infrastructure), including restoring liability for violations (effective July 1, 2023).	Fiscal	End-January 2023
3	Prepare a concept note on how to approach reforms to the social safety net to achieve targeted, adequate, and efficiently delivered social assistance to the population, including newly emerging categories of vulnerable groups, while safeguarding fiscal sustainability.	Fiscal	End-January 2023
4	Prepare a Terms of Reference in consultation with IMF staff describing the methodology and processes of bank diagnostics necessary to assess bank capital adequacy and identify NPL resolution priorities.	Financial sector	End-January 2023
5	Appoint and make fully operational the supervisory board of Naftogaz based on transparent and competitive selection procedures.	Governance	End-January 2023

Table 2. Ukraine: Quantitative Targets and Indicative Targets[1/]
(In millions of Ukrainian hryvnia, unless otherwise stated)

	2022 December QT	2023 March IT
I. Quantitative target		
Floor on the non-defense cash primary balance of the general government, excluding grants (- implies a deficit) 2/	86,950	-8,240
Floor on net international reserves (in millions of U.S. dollars) 3/	15,000	11,500
II. Indicative Targets		
Floor on the overall cash balance of the general government, excluding grants (- implies a deficit) 2/	-1,425,762	-506,476
Ceiling on general government borrowing from the NBU 1/ 2/ 4/	388,500	-7,600
III. Memorandum Items		
External project financing 2/	51,733	13,713
Budget support grants 2/	461,940	182,843
Budget support loans 2/	577,814	164,559
NBU profit transfers to the government 2/	19,700	71,000
Net financing of general government deficit by commercial banks 2/	-101,223	-5,434
Government bonds for the purposes of bank recapitalization and DGF financing	0	0
Called guaranteed debt service 2/	15,000	10,500

Sources: Ukrainian authorities; and IMF staff estimates and projections.
1/ Definitions and adjustors are specified in the Technical Memorandum of Understanding (TMU).
2/ Targets and projections for 2022 are cumulative flows from January 1, 2022. Targets and projections for 2023 are cumulative flows from January 1, 2023.
3/ Calculated using program accounting exchange rates as specified in the TMU.
4/ Calculated using the projected redemption of government bonds for 2022Q4 and 2023Q1 respectively as of November 22, 2022.

Attachment II. Technical Memorandum of Understanding

December 8, 2022

1. This Technical Memorandum of Understanding (TMU) sets out the understandings between the Ukrainian authorities and IMF staff regarding the definitions of the variables subject to targets (both quantitative targets and indicative targets) for the Program Monitoring with Board Involvement (PMB), as described in the authorities' Letter of Intent (LOI) dated December 8, 2022 and the attached Memorandum of Economic and Financial Policies (MEFP). It also describes the methods to be used in assessing program performance and the information requirements to ensure adequate monitoring of the targets.

2. The quantitative targets and indicative targets are shown in Table 1 of the MEFP. The definitions of these targets and the adjustors are described in Section I below. The official exchange rate is defined in Section II. Reporting requirements are specified in Section III.

3. For the purposes of the program, all exchange rates used to evaluate reserve levels and monetary aggregates are (i) the official exchange rate of the Ukrainian hryvnia to the U.S. dollar of 36.5686, set by NBU as of November 21, 2022; and (ii) reference exchange rates of foreign currencies as of November 21, 2022 , as set out below. In particular, the Swiss Franc is valued at 0.9883 Swiss Franc per U.S. dollar, the Euro is valued at 1.020773 euro per U.S. dollar, the Pound Sterling is valued at 0.818121 pound per U.S. dollar, the Australian Dollar is valued at 1.5435 dollars per U.S. dollars, the Canadian Dollar is valued at 1.275149 dollars per U.S. dollar, the Chinese Renminbi is valued at 7.23115 yuan per U.S. dollar, and the Japanese Yen is valued at 132.9378 yen per U.S. dollar. The accounting exchange rate for the SDR will be 0.755898 SDR per U.S. dollar. Official gold holdings were valued at 1,675.63 dollars per fine ounce. These accounting exchange rates are kept fixed over the program period. Therefore, the program's exchange rate may differ from the actual exchange rate set by NBU Ukraine during the Martial Law. Furthermore, setting a program exchange rate for the purpose of computing monetary aggregates does not imply that there is any target exchange rate for policy purposes.

4. The general government is defined as comprising the central (state) government, including the Road Fund (UkrAvtoDor), all local governments, and all extra budgetary funds, including the Pension Fund, Unemployment Fund, the Fund for Social Insurance of Ukraine, the State Financial Housing Company. The budget of the general government comprises (i) the state budget; (ii) all local government budgets; and (iii), if not already included in (i), the budgets of the extra budgetary funds listed above, as well as any other extra budgetary funds included in the monetary statistics compiled by the NBU. The government will inform the IMF staff of the creation or any pending reclassification of any new funds, programs, or entities, immediately.

5. For program purposes, the definition of debt is set out in paragraph 8(a) of the Guidelines on Public Debt Conditionality in Fund Arrangements attached to IMF Executive Board Decision No. 15688-(14/107), adopted on December 5, 2014, as amended.

a. The term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

i. loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

ii. suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and,

iii. leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of these guidelines, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair, or maintenance of the property.

b. Under the definition of debt set out in this paragraph, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

6. For program purposes, gross domestic product is compiled as per the System of National Accounts 2008 and excludes Crimea and Sevastopol.

7. For program purposes, external financing is defined as (Table B):

a. Loans (budget and project support) disbursed to the general government and counting towards general government financing. These include financing from official multilateral creditors (World Bank, European Commission, European Investment Bank, and European Bank for Reconstruction and Development) and official bilateral creditors.

b. Grants (budget and project support) disbursed to the general government of Ukraine. Consistent with government finance statistics, grants are recorded above the line in revenues.

8. For program purposes defense expenditures include expenditures of the defense and security sector pursuant to the Law of Ukraine "On National Security of Ukraine". Such expenditures shall include all current (including wage bill) and capital expenditures.

9. Overdue accounts payable are specified in the Order of the Ministry of Finance N 372 dated April 2, 2014, On the Approval of the Accounting Procedures for Specific Assets and Budget Institutions' Liabilities and On Amending Certain By-Laws on the Accounting for Budgetary Institutions. Accordingly, arrears are defined as the amount of payments due on the 30th day after the deadline for mandatory payment, in line with the legal contract in effect. In instances where the payment deadline is not specified, it counts as the 30th day after the confirmation of goods received, works done and services rendered had been provided.

a. Budgetary arrears on social payments and wages comprise all arrears of the consolidated budget on wages, pensions, and social benefits of the central or local governments. The timeframe for wage arrears follows timeframe consistent with general definition. Considering the specifics of the martial law, information on arrears in the security and defense sector can be presented in an aggregated form.

b. Wages are defined to comprise all forms of remuneration for work performed for standard and overtime work in all subcategories, including defense and security service.

c. Arrears of social funds (Pension Fund, Unemployment Fund, Social Insurance Fund of Ukraine) comprise all benefits of these funds. The arrears on the Social Insurance Fund is at 10th day after the deadline of payment. This definition excludes unpaid pensions to individuals who resided or continue to reside in the territories that are temporarily outside the government control.

I. QUANTITATIVE AND INDICATIVE TARGETS

A. Floor on Net International Reserves

Definition

10. Net international reserves (NIR) of the NBU are defined as the dollar value of the difference between usable gross international reserve assets and reserve-related liabilities to nonresidents, evaluated at program exchange rates.

11. Usable gross international reserves comprise all readily available claims on nonresidents denominated in convertible foreign currencies, consistent with the Balance of Payments Manual

(Sixth Edition) and the Special Data Dissemination Standard (SDDS) (Table 6.1, item A). Excluded from usable reserves, *inter alia*, are:

- any assets denominated in foreign currencies held at, or which are claims on, domestic institutions (i.e., institutions headquartered domestically, but located either domestically or abroad, or institutions headquartered abroad, but located domestically). Also excluded are all foreign currency claims of the NBU on domestic banks, and NBU deposits held at the Interbank Foreign Currency Exchange Market and domestic banks for trading purposes;

- any precious metals or metal deposits, other than monetary gold and gold deposits, held by the NBU;

- any assets that correspond to claims of commercial banks in foreign currency on the NBU and any reserves assets that are (i) encumbered; or (ii) pledged as collateral (in so far as not already included in foreign liabilities, or excluded from reserve assets); or (iii) frozen; and,

- any reserve assets that are not readily available for intervention in the foreign exchange market, *inter alia*, because they are not fully under the control of the NBU or because of lack of quality or lack of liquidity that limits marketability at the book price.

12. For program purposes, reserve-related liabilities comprise:

- all short-term liabilities of the NBU *vis-à-vis* nonresidents denominated in convertible foreign currencies with a remaining maturity of one year or less;

- the stock of IMF credit outstanding;

- the nominal value of all derivative positions[1] (including swaps, options, forwards, and futures) of the NBU and general government, implying the sale of foreign currency or other reserve assets; and,

- all foreign exchange liabilities of the NBU to resident entities (e.g., claims in foreign exchange of domestic banks, and NBU credits in foreign exchange from domestic market), which are not already excluded from reserve assets, but excluding foreign exchange liabilities to the general government, or related to deposit guarantees.

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

Table 1. Ukraine: Components of Net International Reserves

	Type of Foreign Reserve Asset or Liability[1]	NBU Balance Sheet and Memorandum Accounts
1.	International reserves	
	Monetary gold	1100, 1107
	Foreign exchange in cash	1011, 1017
	Demand deposits at foreign banks	1201, 1202, 2746, minus 4746
	Short-term time deposits at foreign banks	1211
	Long-term deposits at foreign banks	1212
	SDR holdings and Reserve Position in the IMF	IMF, Finance Department[2]
	Securities issued by nonresidents	1300, 1305, 1307, 1308, minus 1306
2.	Short-term liabilities to nonresidents *(in convertible currencies)*	
	Correspondent accounts of nonresident banks	3201
	Funds borrowed using repos	3210
	Short-term deposits of banks	3211
	Operations with nonresident customers	3230, 3232, 3233, 3401, 8805
	Operations with resident banks	8815
	Use of IMF credit	IMF, Finance Department

1/ The definitions used in this technical memorandum will be adjusted to reflect any changes in accounting classifications introduced during the period of the program. The definitions of the foreign accounts here correspond to the system of accounts in existence on October 31, 2022. The authorities will inform the staff before introducing any change to the Charts of Accounts of the NBU and the Commercial Banks, and changes in the reporting forms.
2/ Before receiving the monthly data from the IMF's Finance Department, these components will be calculated on the basis of preliminary data from the NBU and memorandum accounts.

Adjustors

- The NIR targets will be adjusted downward by the full amount of the cumulative shortfall in external financing disbursements via NBU (defined in paragraph 7) relative to the baseline projection (Table B).

- The NIR targets will be adjusted downward by the full amount of the cumulative shortfall in net issuance (gross issuance minus debt service) of central government's domestic foreign exchange securities under the amounts expected under the baseline.

- In case the NBU converts any non-reserve currency provided under a central bank swap agreement with the NBU into a reserve currency through an outright sale, a symmetric adjustor will be applied to NIR targets. NIR targets will be adjusted upward by the amount that will be converted into a reserve currency at the time of the conversion. NIR targets will be adjusted downward by the amount of a reserve currency (both the principal and interest due), when the NBU repays the non-reserve currency provided under a central bank swap agreement.

- In case the NBU requests use (draws) any reserve currency provided under a central bank swap agreement with a maturity of over 1 year, a symmetric adjuster will be applied to NIR targets.

NIR targets will be adjusted upward by the amount used with maturity over 1 year. NIR targets will be adjusted downward when the NBU repays these amounts.

- The NIR targets will be adjusted upward (downward) by the full amount of the cumulative excess (shortfall) from the transfer of unencumbered confiscated foreign exchange assets to international reserves at the NBU or, if not transferred to international reserves, by the use of confiscated assets held at other accounts (or any other non-international reserve accounts) to make government FX payments, over (under) the amounts expected under the baseline.

Table 2. Ukraine: Disbursements from IFIs and Official Sources

(Cumulative flows from January 1, 2022, in USD billions, projections starting from November 1, 2022, at program exchange rates) 1/

	Multilateral	Bilateral	Total
End-Dec 2022	12.67	17.24	30.16
Budget Support	11.47	17.04	28.75
Grants	0.63	13.37	14.09
Loans	10.84	3.66	14.66
Project Support	1.21	0.21	1.41
End-Mar 2023 2/	5.19	4.69	9.87
Budget Support	5.00	4.50	9.50
Grants	0.50	4.50	5.00
Loans	4.50	0.00	4.50
Project Support	0.19	0.19	0.38

1/ Excludes IMF emergency financing support to Ukraine under the Rapid Financing Instrument (RFI) In March 2022 and the RFI Food Shock Window in October 2022 totaling SDR 2.012 billion (or US$ 2.693 billion).

2/ Financing assumptions for 2023 here are only indicative for the purpose of program monitoring.

B. Ceiling on General Government Direct Borrowing from the NBU *(Indicative Target)*

Definition

13. General government direct borrowing from the NBU, net of redemptions and repayments, is defined as the cumulative change in the stock of outstanding claims on the general government (as

defined in ¶4) held by the NBU, including general government securities, direct loans and credits, other accounts receivable, and overdraft transfers from the NBU in accounts of the general government. The stock of general government securities held by the NBU will be measured at the face value as reported on the NBU's balance sheet. The change in the stock of general government securities held by the NBU will exclude the securities acquired as collateral under loans provided by the NBU during the measurement period, and loans will exclude those to the Deposit Guarantee Fund. The change in the stock of such claims will be measured relative to the stock as of end December 2021 for end-December 2022 targets, and end December 2022 for March 2023 targets, and adjusted for exchange rate valuation effects. The detailed breakdown of the accounts will be provided in a format agreed with IMF experts.

Adjustors

14. For the end-March 2023 Indicative Target, if the amount of government bond primary issuances in Q1-2023 is higher than UAH 83.215 billion, then the ceiling on general government borrowing from the NBU, net of redemptions and repayments, will be adjusted upward by the smaller of:

- a shortfall in external financing (as defined in ¶7), if any;
- UAH 42.4 billion.

C. Floor on Overall Cash Balance of the General Government Excluding Budget Support Grants (Indicative Target)

Definition

15. The overall cash balance excluding grants is defined as a balance measured in paragraph 16 below, adjusted by the amount of budget support grants recorded above the line in non-tax revenues. The balance is measured on a cumulative basis, starting from January 1st of a calendar year. For program target computational purposes positive number is a surplus and negative number is deficit.

16. The cash balance of the general government is measured by means of net financing flows excluding the impact of valuation changes as:

- Total net treasury bill sales[2](in hryvnias and foreign currency) as measured by the information kept in the NBU registry of treasury bill sales (net treasury bill sales are defined as the cumulative total funds realized from the sales of treasury bills at the primary auction and government securities issued for recapitalization of banks and state-owned enterprises (SOE),

[2] From here on, treasury bills are defined as all treasury securities (including long-term instruments or treasury bonds).

less the cumulative total redemption of principal on treasury bills), excluding bonds issued to recapitalize Naftogaz[3] and other SOEs; plus,

- Other net domestic banking system credit to general government (as defined above) as measured by the monetary statistics provided by the NBU (this consists of all non-treasury bill financing in either domestic or foreign currency extended to the general government by banks less the change in all government deposits in the banking system) as well as any other financing extended by entities not reflected by the monetary statistics provided by the NBU; plus,

- Total receipts from privatization (including the change in the stock of refundable participation deposits and the sale of nonfinancial assets) and the proceeds from uncompensated seizures; plus,

- The difference between disbursements and amortizations on any bond issued by the general government or the NBU to nonresidents for purposes of financing the general government; plus,

- The difference between disbursements of foreign loans attracted by the State (including budget support, project support, including on lent to public enterprises) and the amortization of foreign credits by the general government (including on lent project loans, e.g. budgeted payments on behalf of Ukravtodor); plus,

- The net sales of SDR allocation in the SDR department; plus,

    - the net change in general government deposits in nonresident banks, or other nonresident institutions; plus,

    - net proceeds from any promissory note or other financial instruments issued by the general government.

17. For the purposes of measuring the balance of the general government, all flows to/from the budget in foreign currency (including from the issuance of foreign currency denominated domestic financial instruments) will be accounted for based on paragraph 3 of this TMU. Financing changes resulting from exchange rate valuation of foreign currency deposits are excluded from the computation of balance.

18. The government deposits in the banking system exclude VAT accounts used for electronic administration and escrow accounts of taxpayers used for customs clearance.

D. Floor on Non-Defense Cash Primary Balance of the General Government Excluding Budget Support Grants

[3] These are included in the financing of Naftogaz's cash deficit when they are used (as collateral for a loan, or as an outright sale) by the latter to obtain financing.

19. For the purposes of program monitoring, the non-Defense Cash primary Balance of the General Government excluding budget support grants is defined as the Overall Balance of the General Government excluding budget grants (defined in section C) less interest payments (total interest paid on domestic and external debt) less defense spending as defined in paragraph 6 of this TMU. The balance is measured on a cumulative basis, starting from January 1st of a calendar year.

Adjustors for Balances in part C and D

- The floor on the non-Defense Cash primary Balance of the general government will be adjusted downward (decline in balance) by the full amount of guarantees called on and paid from government resources.
- The floor on the non-Defense Cash primary Balance of the general government are subject to an automatic adjustor corresponding to the full amount of government bonds issued for the purposes of banks recapitalization and DGF financing.
- The floor on the non-Defense Cash primary Balance of the general government will be adjusted upward by the full amount of any increase above the projected stock of budgetary arrears (as defined above in this TMU).

20. For the period of the Martial law, the data from temporarily occupied territories where government has no control is not covered by this TMU.

II. OFFICIAL EXCHANGE RATE

A. Determination of the Official Exchange Rate

21. The official exchange rate of the hryvnia against U.S. dollar is UAH/USD 36.5686 as set by the NBU, effective 9 a.m. 21 July 2022, but remains subject to change. The cross rates are determined by the NBU on the basis of this official exchange rate, and the NBU will aim to make public its cross rates no later than 4 pm of the day, preceding the one for which it is set.

III. REPORTING REQUIREMENTS

A. National Bank of Ukraine

22. The NBU will provide to the IMF ***monthly*** sectoral balance sheets for the NBU and other depository corporations (banks) according to the standardized reporting forms (SRFs), no later than the 25th day of the following month (except for SRFs for the end of the reporting year, which should be provided no later than the 41st day after the reporting year).

23. The NBU will provide to the IMF, ***on a weekly basis***, daily operational data the stock of net and gross international reserves, at both actual and program exchange rates. In addition, it will

provide the full breakdown of NBU accounts included in net international reserves (defined in Table A above) any additional information that is needed for the IMF staff to monitor developments in net and gross international reserves. ***On a monthly basis***, no later than 20th of the following month, the NBU will provide balance data on the stock of net and gross international reserves and flows affecting net international reserves, and no later than the 25th of the following month, the NBU will provide data on the currency composition of reserve assets and liabilities.

24. The NBU will provide to the IMF ***daily information*** on total foreign exchange sales (including total from nonresidents and sales by clients in the interbank market, as well as any obligatory sales, if any) and approved foreign exchange demand in the interbank market, including Naftogaz foreign exchange purchases. The NBU will provide the IMF ***daily information*** on official foreign exchange interventions and intervention quotations in the breakdown agreed with the IMF staff. In this context, it will also provide the results of any foreign exchange auctions. ***On a quarterly basis***, the NBU will provide to the IMF information on the indicators of FX interventions approved by the NBU Board (in case of any changes). The NBU will immediately notify the IMF of any updates to the FX interventions methodology documentation and any decisions that define these parameters.

25. The NBU will provide the IMF ***daily i***nformation on balances held in the analytical accounts 2900 "Accounts payable per transactions for the foreign exchange, banking and precious metals purchase and sale on behalf of banks' clients."

26. The NBU will continue to provide on its web site the ***daily*** holdings of domestic government securities as well as information on primary auctions and secondary market sales. The NBU will provide to the IMF information on ***daily*** holdings of government securities broken down by type of holders at primary market prices at the rate fixed on the day of auction; information on domestic government securities sales, from the beginning of the year at the official rate as of the date of placement, as well as the domestic government securities in circulation, by principal debt outstanding at the official exchange rate as of the date of placement; reports on each government securities auction; data on the purchase and redemption of domestic government bonds from the Ministry of Finance in the NBU's portfolio; and ***monthly report*** on government securities holdings, in the format agreed with the IMF staff, i.e., broken down by currencies and by holders—non-resident investors, resident non-bank, and resident banks, the latter further broken down by bank group (State Participation, Foreign Banking, and Private Capital).

27. The NBU will provide information on ***daily*** transactions (volumes and yields) on the secondary market treasury bills (including over-the-counter transactions and with a breakout for any NBU transactions).

28. The NBU will provide to the IMF its financial statements (income and expenses, balances on the general reserves and the calculations of the profit distribution to the budget) for the current and, if available, projections for the following two years, as approved by the NBU's Board. The IMF is to be notified immediately of any update.

29. The NBU will continue to provide to the IMF ***daily and monthly data*** on the NBU financing operations (including swaps or refinancing) of the banks of Ukraine, and on the operations of mopping up (absorption) of the liquidity from the banking system (including through the CDs issuance) in the formats and timeliness agreed with the IMF staff. ***On a monthly basis***, the NBU will provide information on the collateral that has been pledged to the NBU for loans (by bank and loan type as well as by collateral type, haircut, and currency). ***On a monthly basis***, the NBU will also provide bank-by-bank information on NBU refinancing, broken down by operations (with indications of their settlement and maturity dates), and collateral pools, broken down by asset types and securities (with their values before and after haircuts). ***The weekly and monthly reporting*** of NBU loans and collateral will separately identify which banks are under temporary administration or liquidation.

30. The NBU will provide to the IMF, ***on a monthly basis*** but not later than 30 days after the expiration of the reporting month, (except for data as of the end of the reporting year, which are to be provided no later than on the 41st day after the reporting year ends), core FSIs, as defined in the IMF Compilation Guide, for individual banks in State Participation Group Foreign Banking Group and Private Capital Group.

31. ***On a daily basis and on a monthly basis***, not later than on the 25th day after the termination of the report month (except report data as of the end of the report year, which should be submitted not later than the 41st day after the report year), the NBU will provide the IMF with the depository corporations surveys, including any additional information that is needed for the IMF staff to monitor monetary policy and developments in the banking sector, in particular: net domestic assets, including NBU loans and liabilities with banks and detailed information on loans of the banking sector provided to the general government, with detailed breakdown of this information by indebtedness of the central (state) government and local budgets and the DGF, including in national and foreign currency, by loan and by security, as well as the information on the balances of the funds of the government held at the NBU, in particular, the balances of the Single Treasury Account denominated in the national currency (account 3240 A) and the funds of the Treasury denominated in foreign currency (account 3513 A) and DGF.

32. The NBU will provide to the IMF, ***on a monthly basis***, projections for external payments falling due in the next 12 months. The data on actual settlement of external obligations, reflecting separately principal and interest payments as well as actual outturns for both the public and private sectors, shall be provided on a quarterly basis, within 80 days following the end of the quarter.

33. The NBU will provide to the IMF, ***on a quarterly basis***, the stock of short- and long-term external debt for both public and private sectors. Information on the stock of external arrears will be reported on a continuous basis.

34. The NBU will provide to the IMF, on a ***daily*** basis, data on foreign exchange export proceeds and foreign exchange sales; data on import transactions for goods and services; data on amounts of foreign exchange transferred from abroad to the benefit of physical persons—residents and nonresidents—to be paid in cash without opening an account; data on foreign exchange wires from

Ukraine abroad for current foreign exchange nontrade transactions on the basis of the orders of physical persons; data on sales and purchases of foreign exchange cash by individuals (incl. through banks, exchange offices, and UkrPoshta). The NBU will provide to the IMF ***weekly data*** on the volumes of noncash foreign exchange purchases on behalf of banks' clients and banks broken down by reasons, and on a monthly basis data on certain transfers of non-cash FX from Ukraine to the benefit of non-residents. The NBU ***on a monthly basis*** will provide to the IMF aggregated data on the number and amounts of e-limits granted to legal entities and physical individuals and on the transfer and purpose of foreign exchange outside Ukraine within the e-limits.

35. The NBU will provide to the IMF, on a ***daily*** basis, data on foreign assets and liabilities of the overall banking system (excl. the NBU); data on banks' open foreign exchange positions by main groups of banks; data on deposits on the aggregated basis for the overall banking system (excl. the NBU) broken down by households and legal entities, maturity, as well as by national and foreign currency; data on loans on the aggregated basis for the overall banking system (excl. the NBU) broken down by households and legal entities as well as by national and foreign currency. In addition, the NBU will provide to the IMF, ***on a daily basis***, data on deposits and credits on the aggregated basis for the overall banking system (excl. the NBU) without deposits and credits of banks in liquidation starting from the beginning of 2014 and broken down by households and legal entities, as well as by national and foreign currency***. On a weekly basis***, the NBU will provide the IMF data on foreign assets and foreign liabilities (broken down by domestic and foreign currency) for the individual banks in State Participation Group, Foreign Banking Group and Private Capital Group. ***On a monthly basis***, foreign assets will be broken down by type (i.e., cash and deposits, government securities, nongovernment securities, loans, other) and foreign liabilities by type, holder (i.e., banks, other financial institutions, nonfinancial corporate, and individuals) and remaining maturity (less than one month, one to three months, three to 12 months and over 12 months). For foreign credit lines from banks and for securities, the rollover rates will also be provided.

36. The NBU will provide, ***on a daily basis***, bank-by-bank data for the largest 35 banks on the liquidity ratio and amounts of cash and cash equivalents, available funds in NBU accounts (excl. reserve requirements), correspondent accounts with well-known international banks (excl. encumbered accounts), and deposits from customers. The NBU will also provide, ***on a daily basis***, bank-by-bank data for State Participation Group, Foreign Banking Group, and Private Capital Group banks, total assets and liabilities; loans and claims (by households, legal entities, and banks); and foreign exchange net open position. The data will be reported by domestic and foreign currency. The deposits data will be reported by households and legal entities and by maturity (current accounts, saving accounts, and time deposits). In addition, for the aggregate of the banking sector as well as groups of banks, the NBU will provide data on deposits and credits excluding those banks in liquidation since 2014. The NBU will provide, ***on a monthly basis***, bank-by-bank data on liquidity coverage ratio in all currencies and in foreign currency.

37. The NBU will provide to the IMF ***on a daily basis*** aggregated data on main currency flows, including government foreign receipts and payments by currencies as well as interbank market

operations by currencies. The NBU will continue to provide daily information on exchange market transactions including the exchange rate.

38. The NBU will provide the IMF with information on reserve requirements at the individual bank level, including the breakdown between the reserve requirements fulfilled by reserves and that by government securities.

39. The NBU will provide the IMF, ***on a monthly basis***, bank-by-bank for State Participation Group, Foreign Banking Group and Private Capital Group banks the average interest rate on deposits to customers (by domestic and foreign currency, and non-financial corporations and households, and by maturity—demand and time accounts); and ***on a weekly basis (after Martial Law is cancelled)***, the average interest rate on interbank borrowings (by domestic and foreign currency, and by maturity—overnight, 1–7 days, and over one week).

40. The NBU will provide the IMF, on a ***monthly basis***, in an agreed format, data for the entire banking sector, and on an aggregated and bank-by-bank basis for State Participation Group, Foreign Banking Group and Private Capital Group banks—risk weighted assets and other risk exposures (for ratio H2 and H3 calculation), including for the excess of long-term asset to funding and foreign exchange open position; total regulatory (Tier 1 and Tier 2) and core (Tier 1) capital; capital adequacy ratio for total regulatory (H2) capital and core capital (H3); loans and claims by maturity buckets for households, legal entities, and banks in domestic and foreign currencies; deposits by maturity buckets for households, legal entities, and banks in domestic and foreign currencies; and foreign exchange net open position, split between total foreign exchange assets (long position) and foreign exchange liabilities (short position), and between on- and off-balance sheet.

41. The NBU will provide the IMF, ***on a monthly basis***, in an agreed format, data for the entire banking sector and on a bank-by-bank basis for State Participation Group, Foreign Banking Group and Private Capital Group banks the amount of loans and claims (by households in domestic and foreign currency, legal entities in domestic and foreign currency, banks in domestic and foreign currency, maturity, and by borrower classification categories); collateral for loans and claims (by type of collateral, legal entities in domestic and foreign currency, households in domestic and foreign currency, banks in domestic and foreign currency, and by borrower classification categories; provisions on loans and claims (by households in domestic and foreign currency, legal entities in domestic and foreign currency, banks in domestic and foreign currency, and by borrower classification categories); large exposures (loans equal to or greater than 10 percent of equity), refinanced loans, and restructured loans (by households, legal entities, and banks) (after Martial Law is cancelled); the average interest rate on new loans to customers (by non-financial corporations and households; accrued interest on loans (by domestic and foreign currency); securities and debt financial instruments, with government securities reported separately (by domestic and foreign currency).

42. The NBU will provide the IMF, ***on a monthly basis***, in an agreed format, bank-by-bank for the State Participation Group, Foreign Banking Group and Private Capital Group banks the amount

of deposits of related parties (by domestic and foreign currencies, and households and legal entities); deposits of related parties pledged as (cash cover) collateral (by domestic and foreign currencies, and households and legal entities); other liabilities to related parties (by domestic and foreign currencies); related-party loans (by households, legal entities, and banks); counterparty names and amounts of the largest 20 loans to related parties; collateral for loans and claims on related parties (by type of collateral, legal entities, households, and banks in domestic and foreign currencies, as well as by borrower classification categories); provisions on loans and claims on related parties (by households, legal entities, and banks in domestic and foreign currencies, as well as by borrower classification categories.

43. The NBU will provide to the IMF, ***on a monthly basis***, aggregate and bank-by-bank and by region data on loans and provisions (by households and legal entities, domestic and foreign currencies, and by debtor classification categories); deposits (by households and legal entities, and domestic and foreign currencies); due from banks (by domestic and foreign currencies).

44. NBU will report to the IMF, ***on a monthly basis***, data for each of the banks in the State Participation Group, showing nonperforming loans (NPLs), including migration from NPLs to performing loans (PLs); migration from PLs to NPLs; the form of NPL repayments (cash, loan sales, collateral sales, etc.); write-offs; and other factors (e.g., exchange differences and revaluations) (and compared with banks' respective timebound plans for reducing NPLs once these are approved).

45. The NBU will report to the IMF***, on a monthly basis***, data for the entire banking sector as well as on a bank-by-bank basis by bank groups for State Participation Group, Foreign Banking Group and Private Capital Group banks on cumulative income statements, including total revenues; interest revenues (from loans to households, loans to legal entities, interbank loans, placements with the NBU, securities); revenues from fees and commissions; total expenses; interest expenses (on deposits to legal entities, deposits to households, interbank borrowing, borrowing from NBU, securities issued); fees and commissions paid; salaries and other staff compensation; other operational expenses; net earnings before loan loss provisions; loan loss provisions; net earnings after loan loss provisions; taxes paid; and net earnings.

46. Upon request, the NBU will provide to the IMF banks' net expected outflow of cash for a 30-day period.

47. The NBU will report to the IMF on a **monthly** basis and bank-by-bank the amount by which the State Participation Group, Foreign Banking Group and identified Private Capital Group banks' regulatory capital has been increased. The report will disclose the instrument or transactions by which the regulatory capital has been increased (e.g., capital injection, conversion of subordinated debt to equity, etc.)

48. The NBU will, ***once a month***, inform the IMF any regulatory and supervisory measures against banks violating the NBU regulations on capital adequacy, liquidity ratio norm, large exposures, and related or connected lending, as well as about decisions on declaring a bank as problem or insolvent.

49. The NBU will continue to provide detailed quarterly balance of payments data in electronic format within 80 days after the end of the quarter.

50. The NBU will inform IMF staff if the Treasury does not pay interest or principal on domestic government bonds due to the NBU, deposit money banks, or nonbank entities and individuals. In such case, the NBU will provide information on outstanding interest and principal payments.

51. The NBU will inform IMF staff of any changes to reserve requirements for other depository corporations.

52. The NBU will communicate (electronically) to the IMF staff any changes in the accounting and valuation principles applicable to the balance sheet data and will notify the staff before introducing any changes to the Charts of Accounts and reporting forms of both the NBU and the commercial banks.

53. The NBU Internal Audit Department will continue to provide an assurance report to the Fund, no later than six weeks after each test date, confirming that (i) the monetary data are in accordance with program definitions and have been verified and reconciled to accounting records; and (ii) that there have been no changes to the chart of accounts or valuation methods that would impact the data reporting.

54. The NBU will continue to provide the IMF with a copy of the annual management letter from the external auditor within six weeks of completion of each audit. As required under the Fund's safeguard policy, this will remain in effect for the duration of the arrangement and for as long as credit remains outstanding.

55. Monthly, the NBU will provide to the IMF and the Ministry of Finance data on the monthly coupons and principal to be paid for the period till the end of 2023 (in hryvnia and foreign currency, separately) on the outstanding stock of government securities held by NBU and the public (broken down by resident banks, resident non-bank; and non-resident investors). The data on resident banks will be further broken down by bank group (State Participation, Foreign Banking, and Private Capital) and include ISIN-level. Annually, the NBU will provide information on hryvnia-denominated securities that are indexed (i.e., to inflation; USD), broken down by the type of the owner.

B. Deposit Guarantee Fund

56. The DGF will provide, on a monthly basis, data on the total number and volume of household deposits broken down in groups by deposit size. The data will be reported bank-by-bank for the largest 35 banks and on aggregate for the remaining banks.

57. The DGF will report to the IMF on a monthly basis and bank-by-bank for all banks in the banking system the amount of insured deposits and total household deposits. The data will be reported according to an agreed format, by domestic and foreign currency.

58. The DGF will report to the IMF on a monthly basis and bank-by-bank the total insured deposits and remaining insured deposits to be paid by the DGF for the banks under liquidation and under provisional administration. The data will be reported according to an agreed format, by domestic and foreign currency.

59. The DGF will report to the IMF on a monthly basis the financial position of the DGF, including information about the cash balance, bond holdings, credit lines, and loans. The data will be reported according to an agreed format.

60. The DGF will report to the IMF on a monthly basis the financing arrangements of the DGF, including information about contracted financing from MoF. The data will be reported according to an agreed format.

61. The DGF will report to the IMF on a monthly basis a one-year forecast of the amount and type of financial resources that the DGF expects to receive from MoF, NBU and other entities, the amount that DGF expects to pay out to insured depositors in banks in liquidation, and the amount of asset recoveries expected by DGF. The data will be reported according to an agreed format.

C. Ministry of Finance

62. The Ministry of Finance will provide the IMF with the monthly consolidated balances (end-month) of other non-general government entities, including SOEs, holding accounts at the Treasury no later than 25 days after the end of the month.

63. The Treasury will continue to provide to the IMF reports on daily operational budget execution indicators, daily inflow of borrowed funds (by currency of issuance) to the state budget and expenditures related to debt service (interest payments and principals) including data on government foreign exchange deposits, in a format agreed with IMF staff, 10-day and monthly basis data on the execution of the state, local, and consolidated budgets on the revenue side and data on revenues from the social security contributions, including by oblast breakdown, monthly data on funds, deposited with the Single Treasury Account, on the registration accounts of the entities which are not included in the state sector, information on balance of funds as of the 1st day of the month on the account #3712 "accounts of other clients of the Treasury of Ukraine," on inflow to the State budget from placing Treasury or any other liabilities to households in foreign and domestic currency and their redemption.

64. The Ministry of Finance will continue to provide to the IMF in electronic form monthly and quarterly treasury reports, including on accounts payable by budget institutions no later than 25 and 35 days after the end of the period respectively. The Ministry of Finance will continue to provide to the IMF in electronic form the final fiscal accounts at the end of each fiscal year, no later than March of the following year. Inter alia, these reports will provide expenditure data by programs and key spending units, as well as based on standard functional and economic classifications. In addition, quarterly reports will contain standard information on budget expenses to cover called government guarantees.

65. The Ministry of Finance will report data on the public wage bill (excluding SOEs) in line with the template agreed with the IMF staff, including all payment categories, including defense wages. The Ministry of Finance will provide quarterly Treasury reports on expenditure under the medical guarantee program by economic classification.

66. The Ministry of Finance will provide monthly reports on the borrowing (disbursements, interests, and amortization) of UrkAvtoDor in line with the format agreed with IMF staff. The Ministry of Finance will report to the IMF on a monthly basis information on municipal borrowing and amortization of debt in format agreed with IMF staff.

67. The Ministry of Finance, together with NBU, on monthly basis, will provide information about redemptions of domestic bonds and bills in favor of residents (banks, non-banks) and non-residents. The Ministry of Finance, together with NBU, on weekly basis, will provide information on face value of government bonds redeemed and face value of government bonds placed during the week.

68. The Ministry of Finance will report to the IMF on a monthly basis, no later than 15 days after the end of the month, the cash balance of the general government, with details on budget execution data for privatization receipts of the state and local governments; disbursements of external credits (including budget support and project loans including on lending) to the consolidated budget and amortization of external debt by the consolidated budget; net domestic borrowing of the general government, including net T-bill issuance, issuance of other government debt instruments, and change in government deposits.

69. The Ministry of Finance will provide in electronic form on a quarterly basis, no later than 25 days after the end of the quarter, an updated list of project financing credits (distinguishing grant and loan financing) to be disbursed to the special fund of the State Budget of Ukraine (project-by-project basis), as well aggregated cash expenditures for such projects through the most recent month.

70. The Ministry of Finance will provide data on the stock of all budgetary arrears on a monthly basis, no later than on the 1st day of the second subsequent month, including separate line items for wages, pensions, social benefits accrued by social funds, energy, communal services, and all other arrears on goods and services and capital expenditures. The Treasury will report monthly data on accounts payable for state and local budgets (economic classification of expenditures). The Pension Fund will provide monthly reports on net unpaid pensions to the individuals who resided or continue to reside in the territories that are temporarily outside the government control. The provided information will include defense and law-enforcement.

Arrears general government	November 1st, 2022	December 31, 2022	March 31, 2023
Wages			
Other budgetary spending			
Social spending, including			
Pension			
Social Insurance			
Unemployment			
Local governments			

71. The Ministry of Finance will provide monthly information, no later than 25 days after the end of each month, on the amounts and terms of all external debt contracted or guaranteed by the central government, including external and domestic credit to key budgetary spending units as well as nongovernment units that is guaranteed by the government (amount of sovereign guarantees extended by executive resolutions and actually effectuated; total amount of outstanding guarantees and list of their recipients).

72. The Ministry of Finance will provide to the IMF in electronic form on a quarterly basis, no later than 25 days after the end of the quarter, (a) data on the outstanding stock of domestic and external debt of the state and local budgets (including general and special funds); (b) the monthly forecasts of planned and actual external debt disbursement, amortization, and interest payments (including general and special funds), broken down in detail by creditor categories and currency as agreed with Fund staff. The Ministry of Finance will also report the accumulation of any budgetary arrears on external and domestic debt service.

73. The Ministry of Finance will provide to the IMF in electronic form on a semi-annual basis, no later than 25 days after the end of Q2 and Q4, disaggregated bond-by-bond (loan-by-loan) data regarding the debt stock, associated payments, and disbursements.

74. The Ministry of Finance will provide data on external and domestic credit to key budgetary spending units as well as nongovernment units that is guaranteed by the government (amount of sovereign guarantees extended by executive resolutions and actually effectuated; total amount of outstanding guarantees and list of their recipients) on a monthly basis no later than 25 days after the end of the month.

75. The Ministry of Finance will provide data on the approved budgets and quarterly operational data (daily for the Pension Fund only) on the revenue, expenditures, and arrears, and balance sheets of the Pension Fund (detailed data on the breakdown of revenues and expenditure by main categories are expected for this Fund), the Fund for Social Insurance, Employment Fund (detailed data on the breakdown of revenues and expenditure by main categories are expected for this Fund), and any other extra budgetary funds managed at the state level no later than 50 days after the end of each quarter (each month in case of the Pension Fund). Any within-year amendments to the budgets of these funds will be reported within a week after their approval. The Ministry of Finance

will also report the annual financial statement including the final fiscal accounts of those funds at the end of each fiscal year, no later than April of the following year.

76. The Ministry of Finance will provide, no later than 15 days after the end of each month, monthly data on the budgetary costs associated with the recapitalization of banks and SOEs. This cost includes the upfront impact on the cash balance of the general government of the recapitalization of banks and SOEs as well as the costs associated with the payment of interests, including the respective changes as a result of supplementary budgets. The Ministry of Finance will provide quarterly performance reports for the Fund for Entrepreneurship Development. The registry of fiscal risks would become available to the IMF staff on semi-annual or if available sooner basis.

77. STS will provide monthly data, no later than 25 days after the end of the month, on tax arrears, inclusive of deferred payments, interest and penalties outstanding, in the following two formats:

78. The STS and State Customs Service (SCS) will continue to provide on a quarterly basis, no later than two months after the end of the quarter, a listing of all tax exemptions granted, specifying the beneficiary the exemption provided, the duration, and the estimated subsequent revenue loss for the current fiscal year. Revenues foregone include losses from the simplified tax regime by groups of beneficiaries.

79. The STS will continue to provide monthly information, no later than 25 days after the end of the month, on VAT refunds in the following format: (i) beginning stock of refund requests; (ii) refund requests paid in cash; (iii) refunds netted out against obligations of the taxpayer; (iv) denied requests; (v) new refund requests; (vi) end-of-period stock of requests; and (vii) stock of VAT refund arrears (unsettled VAT refund claims submitted to the STS more than 74 days before the end of period.

80. The STS will continue to provide monthly reports 1.P0 on actual tax revenue and 1.P6 on tax arrears, no later than 25 days after the end of each month.

Tax Arrears by Codes	Total stock, o/w	Principal	Interest	Penalties	Tax Arrears of Taxpayers Undergoing Bankruptcy	Total Tax Arrears net of Taxpayers in Bankruptcy Procedures
Taxes from Code 11010000 to 31020000						

81. The STS will provide on a quarterly basis but no later than 25 days after the end of each quarter information on the number of tax appeals and the associated disputed amounts received by the STS in each reporting period, the number of internally resolved appeals indicating the number of appeals resolved in favor of the controlling body, in favor of taxpayer and partial satisfaction.

D. Ministry of Economy, National Commission in Charge of State Regulation in Energy and Utilities (NEURC), GTSO, Naftogaz and Ministry of Development of Communities and Territories

82. For each month, no later than the 25th of the following month, Naftogaz Group and the GTSO will each provide IMF staff with information in electronic form (in an agreed format) on their cash flows. The report from Naftogaz Group will also provide information on volumes and prices of gas purchases and sales (purchase of domestic and imported gas, sales to households, heating utilities, budget institutions, and industries), and the main revenue, expenditure, and financing items. On a monthly basis, Naftogaz will provide to IMF staff updated information on the company's financial liabilities, with a schedule of loan-by-loan interest and principal payments.

83. The Ministry of Economy will provide on a quarterly basis, but no later than 80 days after the end of each quarter consolidated information from the financial statements of the 10 largest SOEs. Specifically, the information will include data on (a) gross profit/losses; (b) net financial results; (c) subsidies received from the budget; (d) guarantees granted from the budget; (e) stock of debt, broken down by domestic and foreign; (f) taxes and dividends paid; (g) wage arrears; and (h) other payment arrears.

E. State Statistics Service

84. In case of any revisions of gross domestic products, the State Statistics Service will provide to the IMF revised quarterly data on gross domestic product (nominal, real, deflator) and their components (economic activities, expenditure, income), no later than 10 days after any revisions have been made.

F. Ministry of Social Policy

85. The Ministry of Social Policy will collect and submit to IMF staff on a quarterly basis data on social assistance programs, including those existing before the war and newly emerging categories. The data, which will be presented in an agreed excel format, will show for each program, including IDPs (a) the number of households receiving help under HUS and other support categories; and privileges in the reporting month; (b) total value of transfers; (c) total value of outstanding HUS debt (d) income per capita of participants, both for HUS and privileges.

Statement by Vladyslav Rashkovan, Alternative Executive Director for Ukraine
December 19, 2022

On behalf of the Ukrainian authorities, I would like to thank staff for the in-depth reports and constructive engagement during regular and remote missions, and the helpful technical assistance. I also want to thank Management and the Executive Board for their continued support of Ukraine.

My authorities are in broad agreement with the sober staff assessment of the devastating social and economic impact of Russia's invasion. Risks remain exceedingly high, but even in such an exceptional macroeconomic and security environment the authorities reaffirm their strong commitment to the policies and objectives under the new IMF program.

The Ukrainian authorities see the PMB program reaching three interconnected objectives: (1) support in the continuation of adapting macroeconomic, fiscal, budgetary, and monetary policies to the fast-changing macro and security circumstances; (2) pave the way towards a near-term upper credit tranche quality arrangement; (3) ensure adequate resources for core functions of the state - thanks to the IMF's strong role in donor coordination.

To address those objectives the authorities are committed to implement sound economic policies, preserve the hard-won gains from past Fund-supported programs, and build the 2023 budget execution framework to achieve the wartime spending goals, while sustaining macroeconomic stability and preparing for the post-war era. Despite tremendous pressures and uncertainty, the authorities are determined to continue improving the public financial management framework, considering the overarching strategy to secure commitments for a financing mix that supports macroeconomic stability.

The authorities also agreed, with the help of Technical Assistance from the Fund, to work on developing an integrated roadmap for tax policy and administration measures to restore the short-term tax administration and policies to their pre-war setup, in parallel with protecting the current level of social assistance for the most vulnerable groups of the population.

While the authorities remain fully committed to upholding the independence and institutional effectiveness of the National Bank of Ukraine (NBU), the NBU continues focusing on safeguarding price and exchange rate stability, protecting international reserves, maintaining an appropriate monetary policy stance that will help alleviate price pressures, and increasing the attractiveness of hryvnia assets. The adequate levels of FX reserves to support exchange rate stability will be maintained and provide a buffer against adverse shocks, given prevailing uncertainty. Reducing and then eliminating monetary financing will help safeguard price and external stability and safeguard the NBU's independence.

In this statement below, I will focus on (i) some details of the war economy and macro effects of the recent escalation; (ii) the recent central bank and government responses to macro shocks; and (iii) external financing needs and the IMF's central role in donor coordination.

War economy

The Ukrainian economy continues to suffer from the unprovoked, unjustified, and illegal invasion by Russia, which started on February 24, 2022. Every day Russia's invasion brings devastating social impact on the country, additional losses of human capital, massive population displacement, on a scale not seen since World War II, infrastructure damages, loss of access to basic needs, and deep economic scars. Based on the global threshold of US$6.85 a day (2017 PPP), the World Bank projects that the poverty in Ukraine will increase from 5.5 percent in 2021 to 25 percent in 2022, with major downside risks if the war and energy security situations worsen.

At the same time, following the deepest decline in Q2'2022 with the real GDP dropping by 37.2% YoY, economic activity started gradually reviving as businesses and households have been gradually adapting to the new conditions. Flash estimate for Q3'2022 showed real GDP grew 9% QoQ, while in annual terms the decrease slowed to 30.8%. Largely, the recovery was supported by the liberation of occupied territories, the establishment of the "grain corridor", recovering logistics, and the relocation of enterprises to areas with fewer security risks.

Inflation accelerated to 26.5% YoY in November due to the consequences of Russia's full-scale war on Ukraine, including the disruption of supply chains, the destruction of production facilities and infrastructure, the reduction of the supply of goods and services, logistical difficulties, especially for non-food exports, and the increase in business costs. At the same time, inflation came below the NBU's expectations and flattened compared to October, mainly because of a higher raw food supply, better FX market performance, and the stabilization of inflation expectations.

While Ukraine has been succeeding in liberating occupied territories, most recently forcing Russia's troops to withdraw from Kherson, Russia continues to brutally attack Ukraine, particularly targeting our energy infrastructure. The massive missile strikes intensified since mid-October, leading to significant electricity outages, and cutoffs in water and heating all over Ukraine. As a result, access to basic needs such as electricity, water, and heating are at risk, with the winter coming.

Although businesses are trying to adapt by purchasing generators and other equipment to help restore emergency power and heat, and by shifting production to night shifts, the shortage of electricity led to a weakening of economic activity, a reduction in production, and an increase in business costs. The power outages adversely affect various sectors – from the metals and food industry to animal farming and the service sectors. This, in turn, worsened the labor market performance: both demand and supply of labor have weakened. The high-security risks increase the probability of a new wave of migrants abroad.

Public finances remain under extreme pressure. The cumulative general government deficit, excluding grants, ballooned to 15.9 percent of GDP in September, whereas the overall fiscal deficit was lower, at about 8.7 percent of GDP, on account of substantial external grants. In total the fiscal deficit has been financed mainly by external and monetary financing.

Despite the recent escalation, the Ukrainian banking system has been successfully resisting the wartime challenges: the banks operate without interruption, maintain their liquidity, and continue to lend (although corporate loan portfolios grew only at state-owned banks on the back of state support programs while retail lending declined).

This became possible thanks to the banks' coordinated efforts, a timely response by the NBU, and years of joint work on reforming the sector since 2014, also with the help of previous IMF programs. As a result, the banks faced the war with significant capital and liquidity cushions. They were operationally stable and efficient and had contingency plans ready. The financial institutions have withstood numerous cyberattacks, which intensified greatly in February. To secure their data, the banks moved them to cloud data warehouses. The high level of digitalization in Ukraine, including in the financial sector, helps customers go through the crisis with slightly less pain.

In the regions liberated this summer the banking network is now almost fully open for business, while the operation of branches in regions liberated in autumn has been recovering rapidly. Depositors have retained confidence in the banks. In addition to growth in hryvnia retail and corporate bank deposits, term deposits in hryvnia and foreign currencies have started to increase in Q3'2022 for the first time since the start of the war. This helped maintain the strong liquidity of the banking system. Despite heavy provisioning and thanks to sustained operational efficiency, the sector posted a profit in Q3'2022, following a loss in the first half of the year.

That said, the banking sector was hit hard by the war. Current estimates of banks' expected losses are still not conservative enough. Banks stand to lose at least 20% of their loan portfolio due to the war and the economic crisis. Such losses will have a significant impact on capital adequacy. To have a full assessment of banks' portfolios, the NBU will hold an asset quality review next year.

Recent macroeconomic and fiscal policies

Macroeconomic management in recent months has been exceedingly difficult. The government of Ukraine saved its full operational capacities in all main areas. Notwithstanding the war strains, the authorities have largely managed to maintain macroeconomic and financial stability, and they are committed to taking necessary measures to preserve stability.

The macroeconomic stabilization was supported by ensuring continuity of budgetary payments, mobilization of international financial support, including via the IMF Administered Account, achieving consent for debt standstill with external private and bilateral creditors, and launching state-funded programs to support the seeding campaign in spring 2022.

Over January-November 2022, the state budget deficit widened to a record high of UAH 1,152 bn (excluding grants) as revenues shrank due to a sharp contraction in economic activity and temporary tax reliefs, while expenditures rose substantially to meet defense needs, social and infrastructure support measures.

To finance the country in the face of a full-scale invasion, on March 1, just five days after Russian troops invaded Ukraine, the Ministry of Finance started issuing government "war bonds" through auctions, in which both local and international investors could participate. Issuance of local bonds, including wartime bonds, already accumulated north of $7 billion. The Ministry of Finance continues an active dialogue with international investors investing in Ukrainian hryvnia bonds and extends the offer of benchmark instruments to the market. Together with the NBU, the Ministry of Finance developed a capital control lifting solution aimed to boost reinvestments into hryvnia bonds from international investors.

2023 will bring another large uptick in the fiscal deficit as the war consequences continue to keep revenues subdued while expenditures remain high, including due to the start of infrastructure rebuilding purposes. However, budget law foresees a moderate fiscal consolidation as the deficit ratio to GDP narrows (to about 20.6%).

Since the beginning of the full-scale war, the NBU temporarily moved away from the classic inflation-targeting framework. Instead, the NBU fixed the official exchange rate of the hryvnia, imposed a number of administrative restrictions on FX transactions and capital movement, and temporarily postponed its key policy rate decisions. However, as the economy was showing signs of recovery, the NBU returned in June to an active monetary policy, hiking its key policy rate by 15 pp, to 25%, and kept it at this level thereafter. Gradually, these decisions led to higher interest rates on deposits and yields of domestic government debt securities.

The NBU adjusted the hryvnia official exchange rate to the US dollar by 25% and fixed it at a new level. This measure was aimed at supporting Ukrainian producers, reducing demand for foreign currency, and balancing the FX market, thus improving the resilience of the economy. The new level of the exchange rate continues to serve as the nominal anchor for the economy at times of uncertainty. The fixed exchange rate and the NBU's FX interventions, combined with capital restrictions, proof to be effective instruments for maintaining macrofinancial stability since the onset of the war. As a result, pressures in the FX market eased, and foreign reserves remain broadly adequate.

In light of everything they have experienced since the start of the Russian invasion, the Ukrainian authorities are well aware that economic and fiscal outcomes remain subject to large risks. They are well accustomed to responding promptly to such unexpected shocks. They have prepared contingency plans for major risks and will continue to do so. In that regard, in the event of a major downside scenario, they would seek additional support from major donors and stand ready to take all possible measures, including taking further steps to boost domestic financing and revenues where feasible.

Coordination of donors

Since the start of Russia's invasion, the government of Ukraine has been ensuring the financing of the security and defense sector, social expenditures, pension payments, and wages for teachers and healthcare workers in full. International financial support, both through credit and grants, was the main source of budget needs financing.

While the IMF's role in the international donors' coordination was sizable and visible, the timely emergency financing provided by the IMF was by far not sufficient to consider the role of the Fund as central. The success and effectiveness of the IMF Administered account were also limited compared to the World Bank Multi-Donor Funds (MTDF).

Nevertheless, since the beginning of the war, many rounds of negotiations with key international partners and donors resulted in more than $27 billion of foreign funding disbursed to Ukraine up to this date. International financing has also been key in supporting the NBU's international reserves, which stood at $28 billion as of the end of November, almost unchanged compared to the pre-war level.

2023 public finances will remain under extreme pressure in any scenario. While the Ministry of Finance is committed to not utilize the monetary financing to cover its budgetary needs, the NBU and the Ministry of Finance agreed on mechanisms to revamp the domestic debt market to finance government spending.

The authorities will strive to maximize the issuance of domestic government securities in the primary market, with the objective of covering the redemptions expected in 2023. In order to achieve this, they are committed to adjusting the yields on government securities offered on the primary market to match market demand and support price discovery. The latest treasury auction to mobilize financing led to an almost 100% rollover rate for government bonds, which gives hope for a fast stabilization of the domestic market. Nevertheless, external financing, including from the IMF, will remain the central pillar of the financing mix.

The authorities see a 4-months PMB as an interim step toward a near-term UCT-quality IMF arrangement. Though it is clear that no single institution's balance sheet can meet all of Ukraine's financing needs, and no bilateral donor or multinational financial institution can tackle Ukraine's recovery and reconstruction single-handedly. Therefore, we need a strong plan to coordinate all donors and partners, and the IMF should continue playing its leadership and catalyzing role in it.

This week the G7 countries issued a statement in which they confirmed their plans to establish a multi-agency Donor Coordination Platform for Ukraine. This initiative is very welcomed by the Ukrainian authorities. Through this platform, the main partners of Ukraine will coordinate existing mechanisms to provide ongoing short- and long-term financial support. The first meeting of the Platform is expected in January 2023, within the term of the current PMB. The authorities believe that the PMB will build up a necessary macro framework for other donors to provide financing to Ukraine. The authorities support the view of the G7 countries that the IMF should have a central role in this effort.

Concluding remarks

In this challenging context, the Ukrainian authorities have requested a 4-month PMB, tailored to the Ukrainian exceptional circumstances, to help them prepare for the necessary macroeconomic adjustment during this particularly difficult period and to catalyze donor financing.

The authorities remain strongly committed to the full and timely implementation of the policies under the PMB to achieve its goals. They believe that policies under the PMB are sufficiently robust to meet the authorities' objectives under the program and build a track record towards a UCT-program.

The authorities are grateful for the cooperation and support from the Fund, as well as from other IFIs and the international community.