

UKRAINE AND THE IMF

FPP COURSE – OPEN LECTURE

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Ukraine and the IMF

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



Background: Unsustainable macroeconomic policies

A largely inadequate policy mix:

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

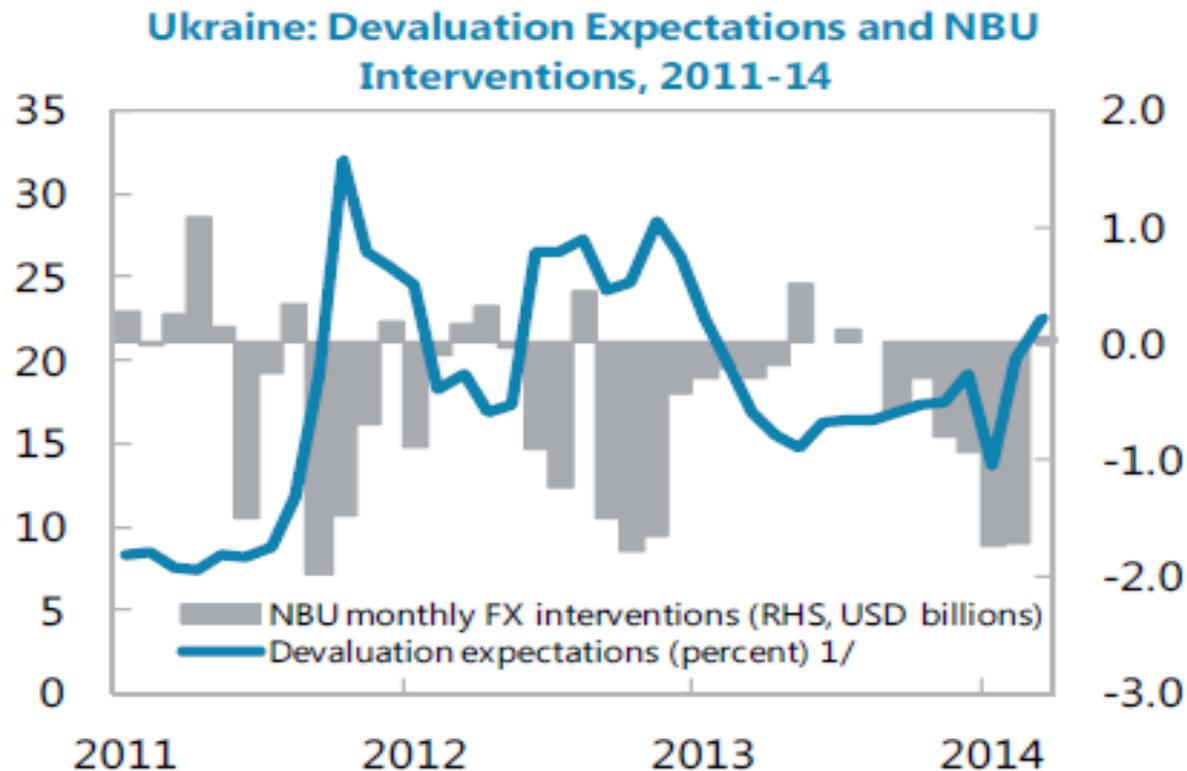


Background: Lack of structural reforms

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



Exchange rate policy lacked credibility



Sources: NBU; Bloomberg; and staff estimates.

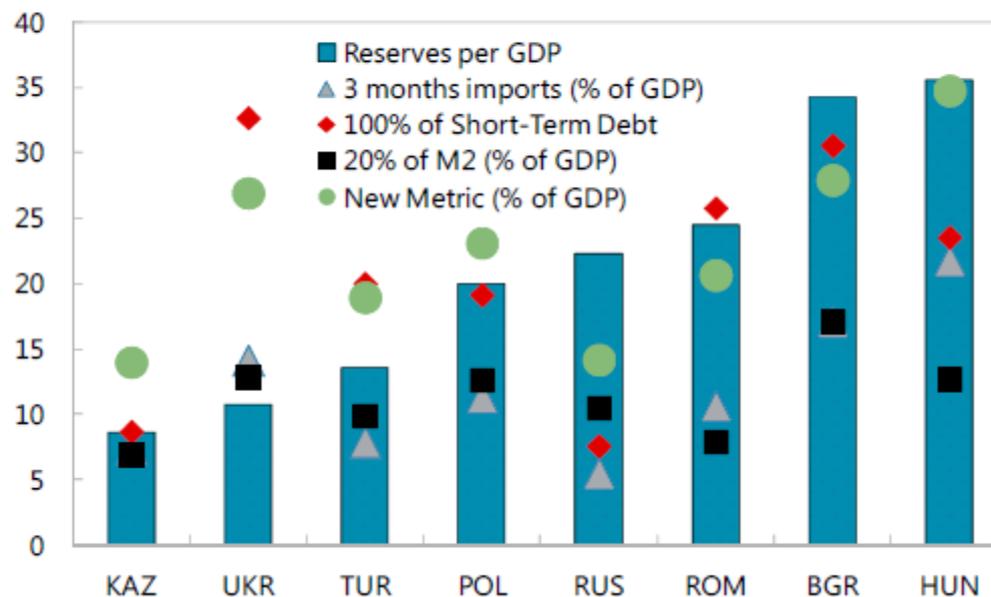
1/ Derived from 12-month NDF contracts on hryvnia.



Level of reserves was inadequate

Reserve Metrics in Selected Countries, 2013

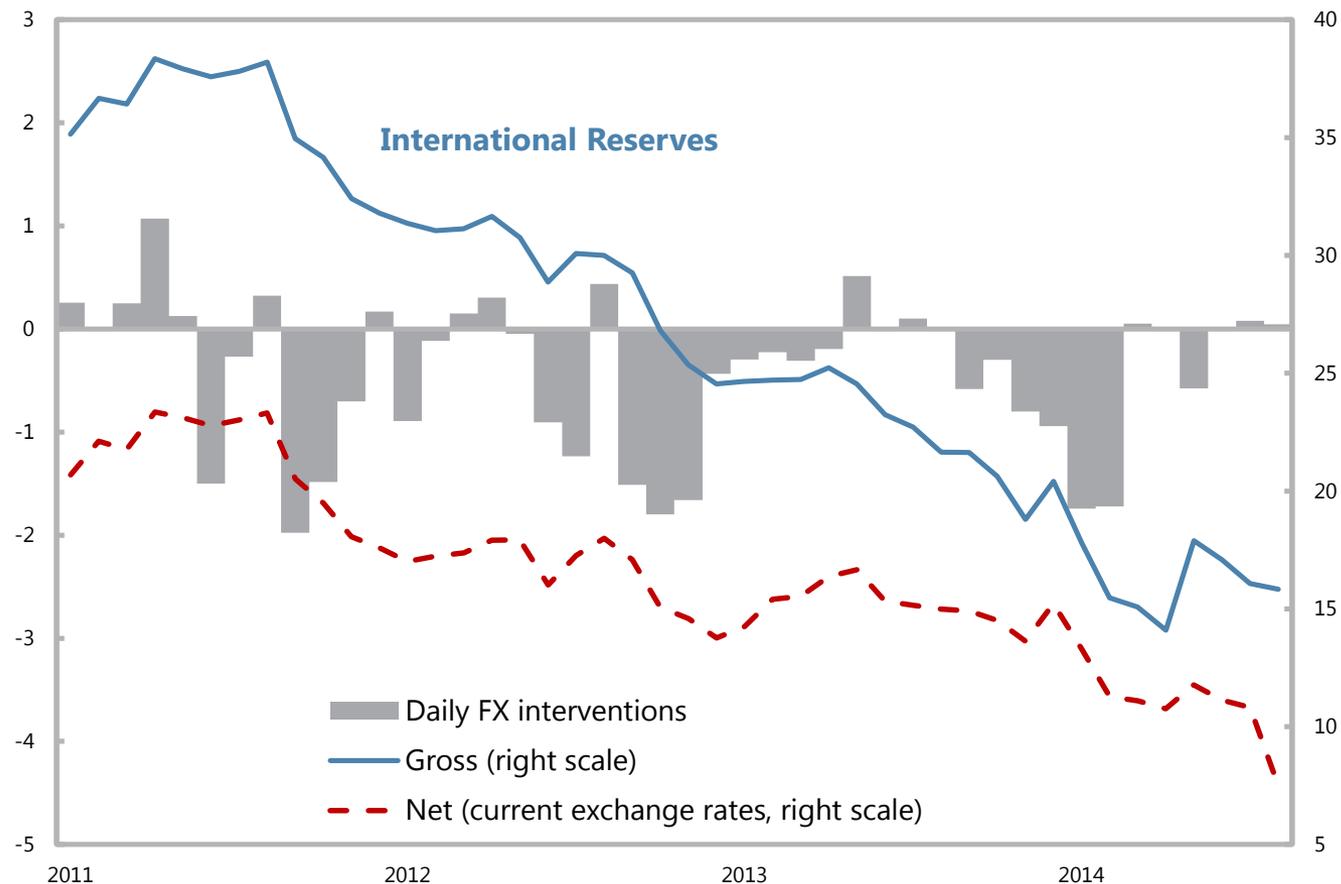
(Percent)



Sources: National authorities and IMF staff estimates.

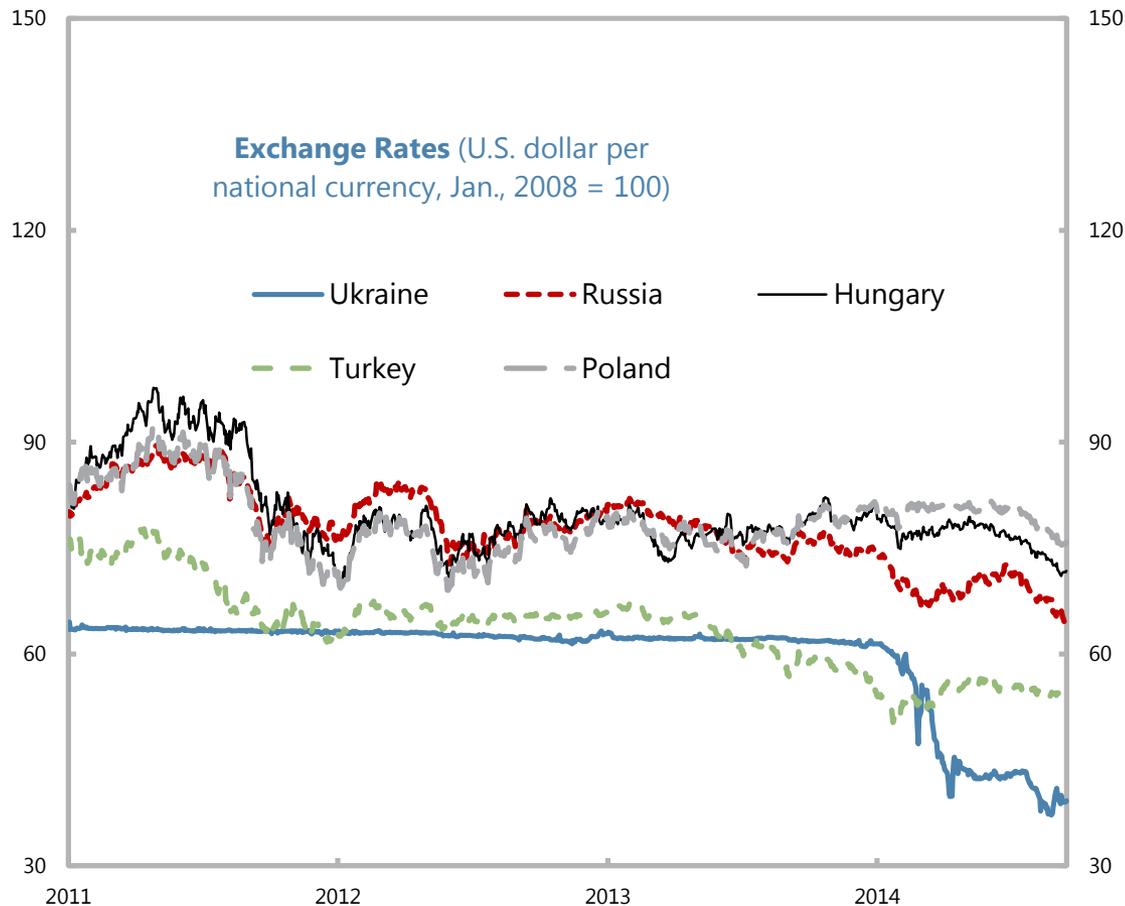


Gradual depletion of reserves reflected imbalances





The hryvnia started to float at the end of January





An IMF supported program

- New authorities in place and cooperating quickly
- Challenging situation (imbalances quickly unwinding, security situation deteriorating)
- Previous experiences with programs with Ukraine calling for a strong reform package



IMF's previous lending to Ukraine

Table 2. Ukraine: IMF Financial Arrangements and Fund Exposure, 1994–2021
(In millions of SDR)

Year	Type of New Arrangement	Date of Arrangement	Date of Expiration or Cancellation	Amount of New Arrangement	Amount Drawn	Number of reviews Envisaged	Completed	Fund Exposure 1/
1994	STF	2/ 26-Oct-1994		498.8	498.8	0	n/a	249.3
1995	SBA	7-Apr-1995	6-Apr-1996	997.3	538.7	4	3	3/ 1,037.3
1996	SBA	10-May-1996	23-Feb-1997	598.2	598.2	3	3	1,573.3
1997	SBA	25-Aug-1997	24-Aug-1998	398.9	181.3	4	1	3/ 1,780.6
1998	EFF	4-Sep-1998	3-Sep-2002	1,920.0	1,193.0	12	6	3/ 1,985.0
1999								2,044.6
2000								1,591.2
2001								1,520.7
2002								1,380.0
2003								1,235.5
2004	SBA	29-Mar-2004	28-Mar-2005	411.6	0.0	1	0	1,033.7
2005								830.9
2006								551.9
2007								272.9
2008	SBA	5-Nov-2008	27-Jul-10	11,000.0	7,000.0	8	2	3,057.3
2009								7,000.0
2010	SBA	28-Jul-2010	27-Dec-12	10,000.0	2,250.0	9	1	9,250.0
2011								9,250.0
2012								7,015.6
2013								3,359.4
2014	SBA	April 30, 2014	March 15, 2016	10,976.0		8		5,770.8 4/
2015								10,290.0 4/
2016								10,976.0 4/
2017								10,232.8 4/
2018								6,802.8 4/
2019								2,143.8 4/
2020								85.8 4/
2021								0.0 4/

Source: Finance Department.

1/ As of end December, unless otherwise stated.

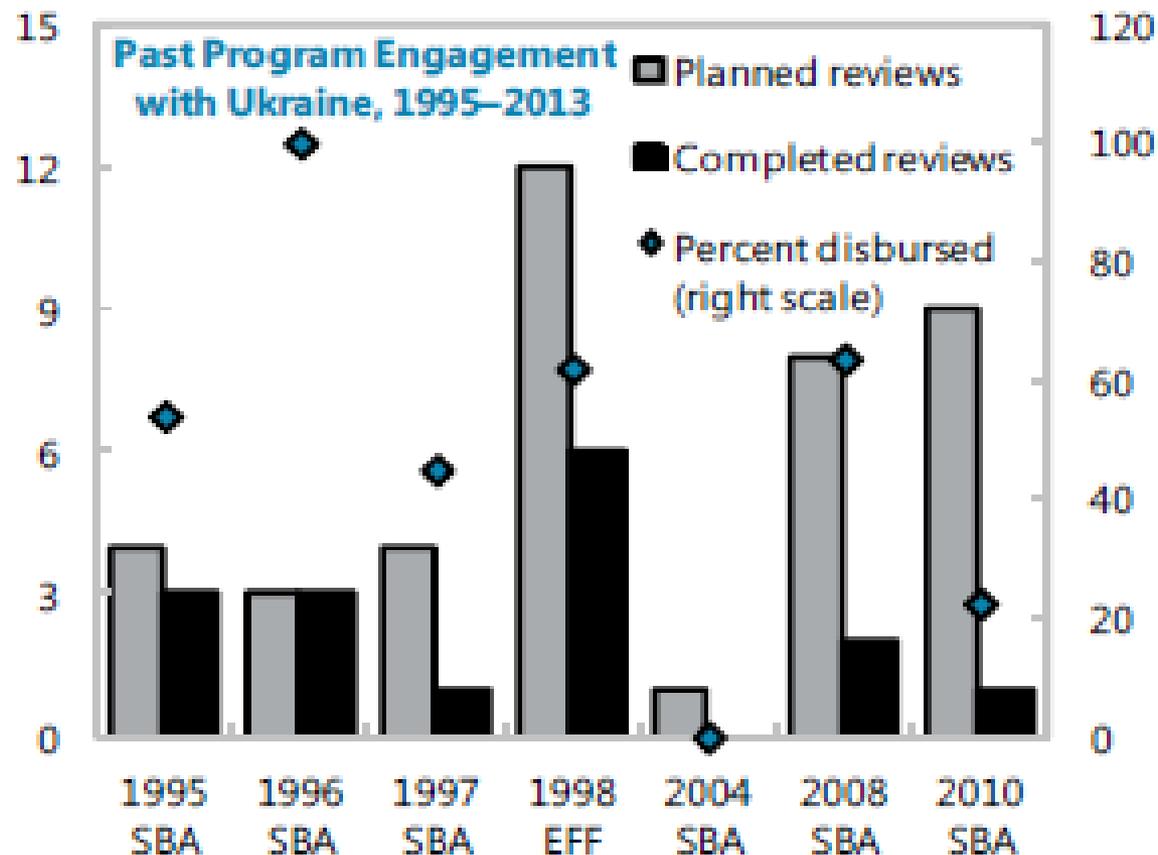
2/ The Systemic Transformation Facility (STF) was created in April 1993 and allowed to lapse in April 1995.

3/ Completed with delays or waivers.

4/ Figures including transactions under the proposed program are in italics. Fund exposure is derived assuming purchases are made as per the schedule in Table 1 and Ukraine remains current on all its scheduled repurchases.



Commitment to reforms had been weak



Source: IMF staff estimates.



Commitment through program design

- Stand By Arrangement over 2 years
- Exceptional Access
- 8 reviews (the first two on a bi monthly basis) and 9 tranches
- 12 prior actions for program approval
- Board approval on April 30
- First tranche: 3.2 bn USD



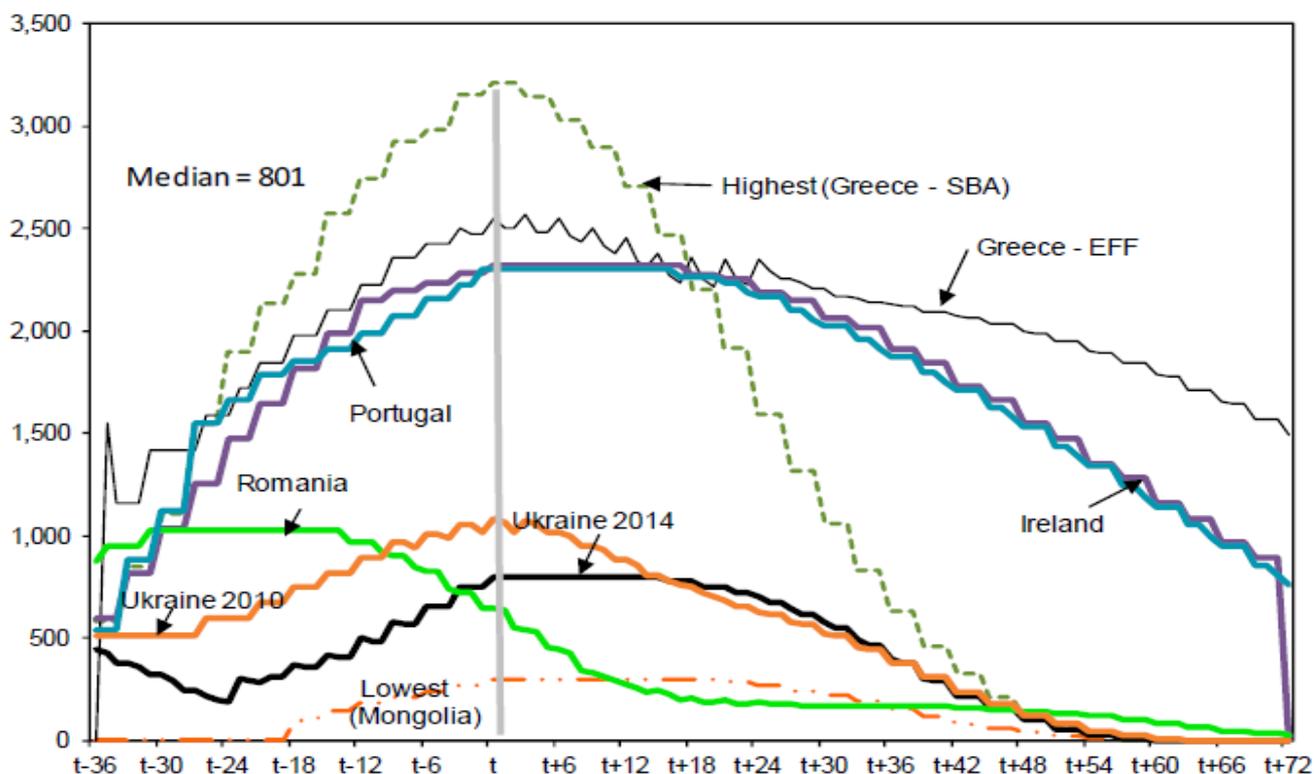
Exceptional access criteria

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



Exceptional access in perspective

Approved Exceptional Access Cases since September 2008 2/



Source: IFS, Finance Department, and IMF staff estimates.

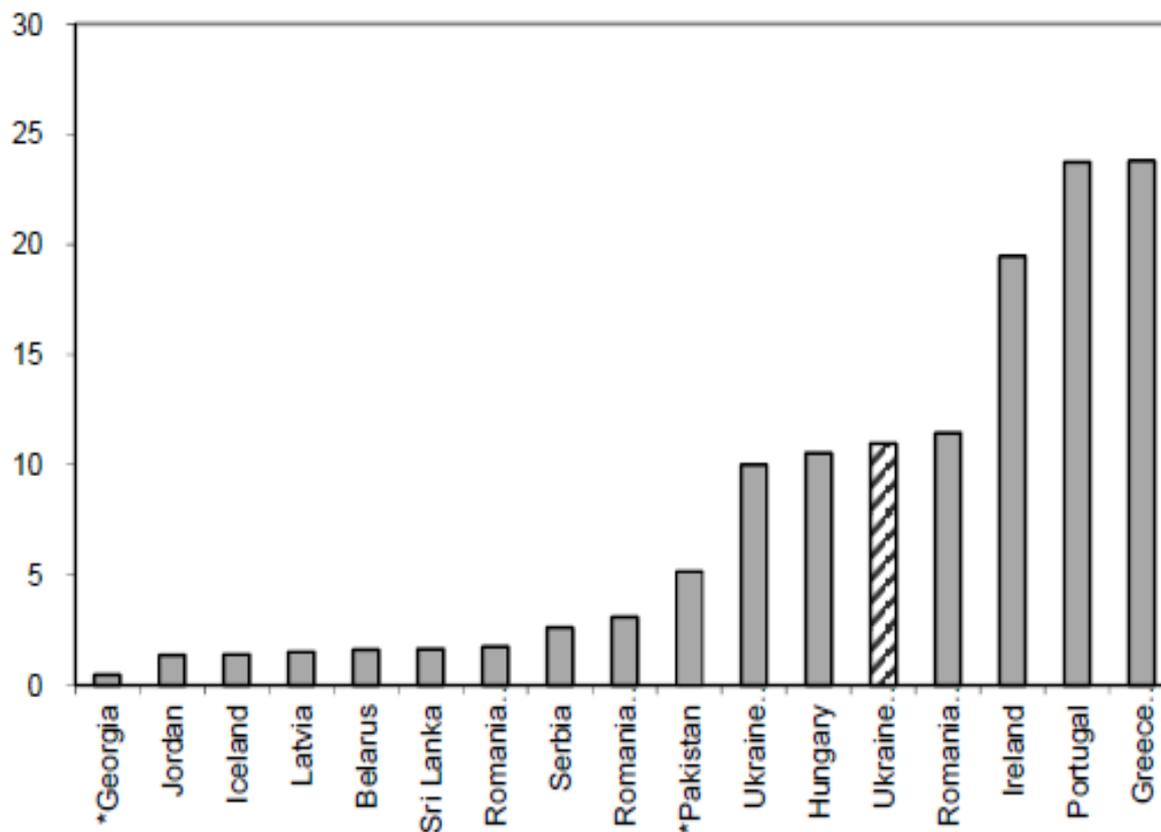
1/ Peak borrowing 't' is defined as the highest level of credit outstanding for a member. Repurchases are assumed to be on an obligations basis.

2/ Based on post-2008 reform quota. Median credit outstanding at peak is 801 percent of quota; average is 1053 percent of quota.



Exceptional access in perspective

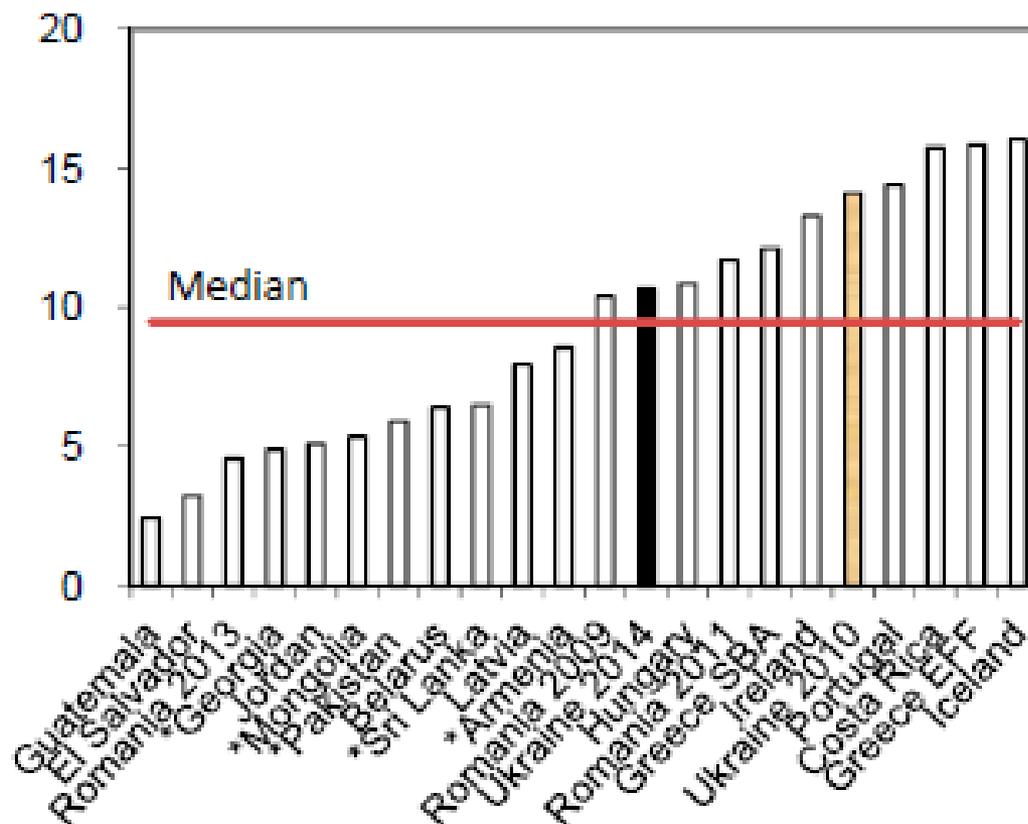
A. Total Access of Recent Exceptional Access Arrangements 1/
(In billions of SDRs)





Exceptional access in perspective

A. In Percent of GDP





5 key areas

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



Fx and monetary policies

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



Financial sector stabilization and reform

1. Maintain confidence in the financial system
 - Diagnostic and stress tests for the largest banks
 - Ensure that banks strengthen their balance sheets, notably through recapitalization
2. Strengthen the infrastructure for financial regulation and supervision, including bank resolution



Fiscal adjustment

Pace of fiscal adjustment calibrated to restore confidence in public finances without being overly contractionary

- Expenditure restraint
 - Suspension of unaffordable wage and pension increases
 - Public employment reduction through attrition
 - Savings on government purchases



Fiscal adjustment

- Enhanced revenues and collections
 - Elimination of fraudulent tax evasion schemes
 - Higher excises
 - Closing of VAT loopholes



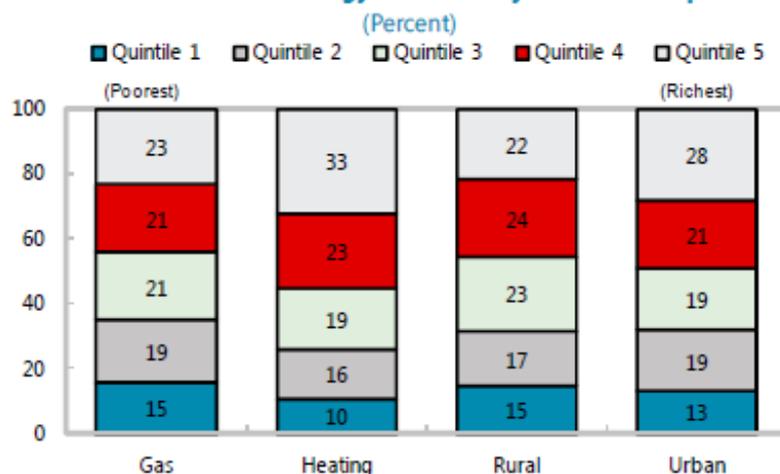
Energy sector reform

1. Increased gas and heating tariffs over time
2. Accompanied by enhanced social assistance measures to mitigate the impact on the poorest (shift of subsidies directly to households that need it)
3. Improvements in governance and transparency and reduction in operational costs at Naftogaz

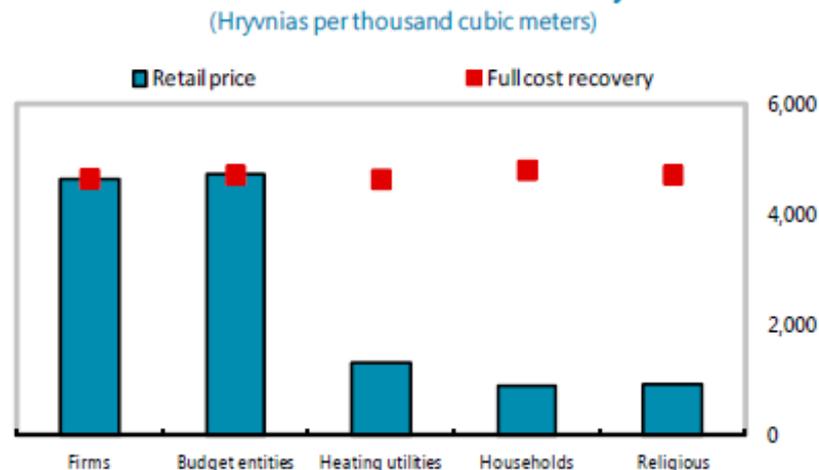


Gas and heating tariff adjustments are highly needed

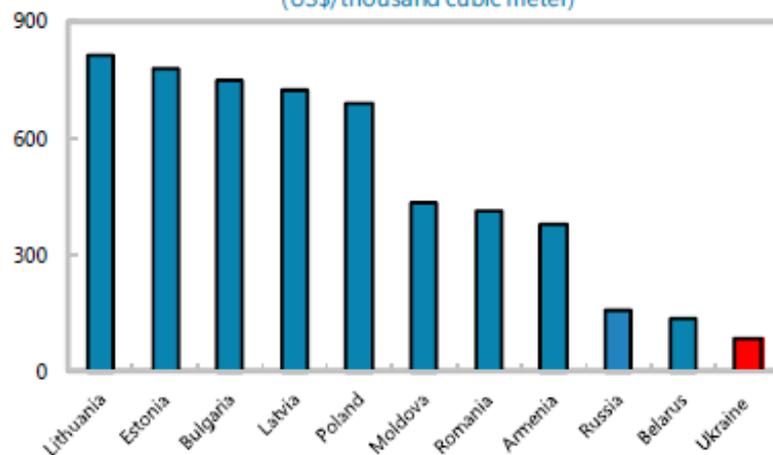
Distribution of Energy Subsidies by Income Groups



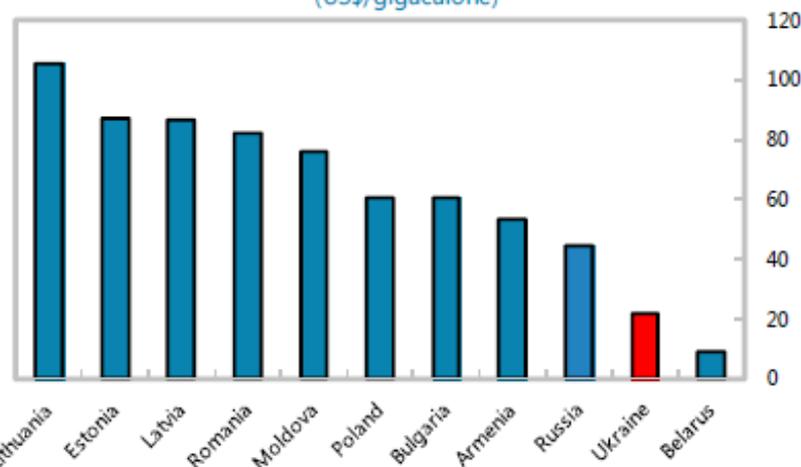
Gas Tariff's Distance to Cost Recovery



Natural Gas Tariffs in Select Transition Economies
(US\$/thousand cubic meter)



Heating Tariffs in Select Transition Economies
(US\$/gigacalorie)



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



Structural reforms

1. Stronger emphasis on anti corruption
2. Procurement law and improvements in tax administration
3. Improvements in the business environment (deregulation)
4. Diagnostic study with the government on anti corruption, business environment and the judicial system



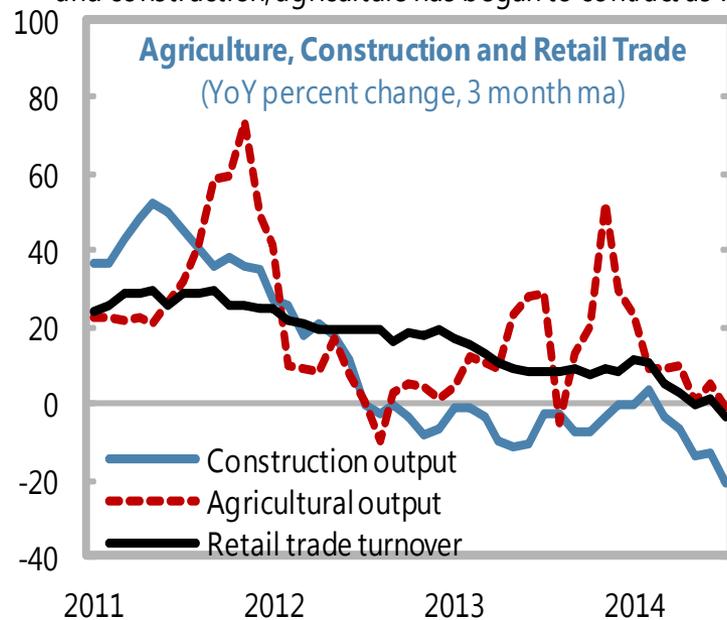
Challenges and risks

- Deeper challenges materialized in the spring:
 - Crimea
 - Growing conflict in the East
- Multi faceted impact:
 - Real economy
 - Fiscal
 - Financial sector
 - Balance of payments

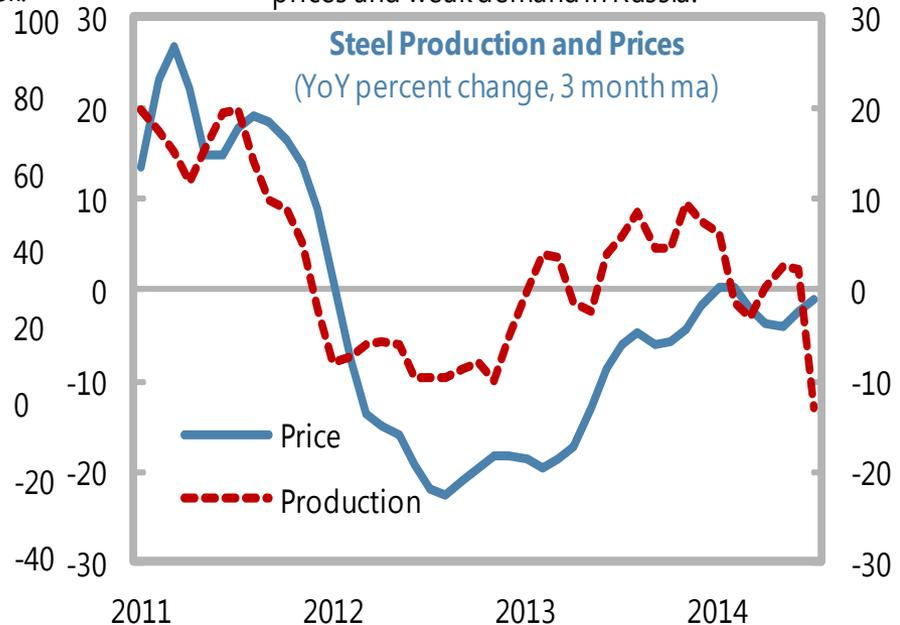


Activity and commodity prices remain depressed

Political and economic instability have affected retail trade and construction; agriculture has begun to contract as well.



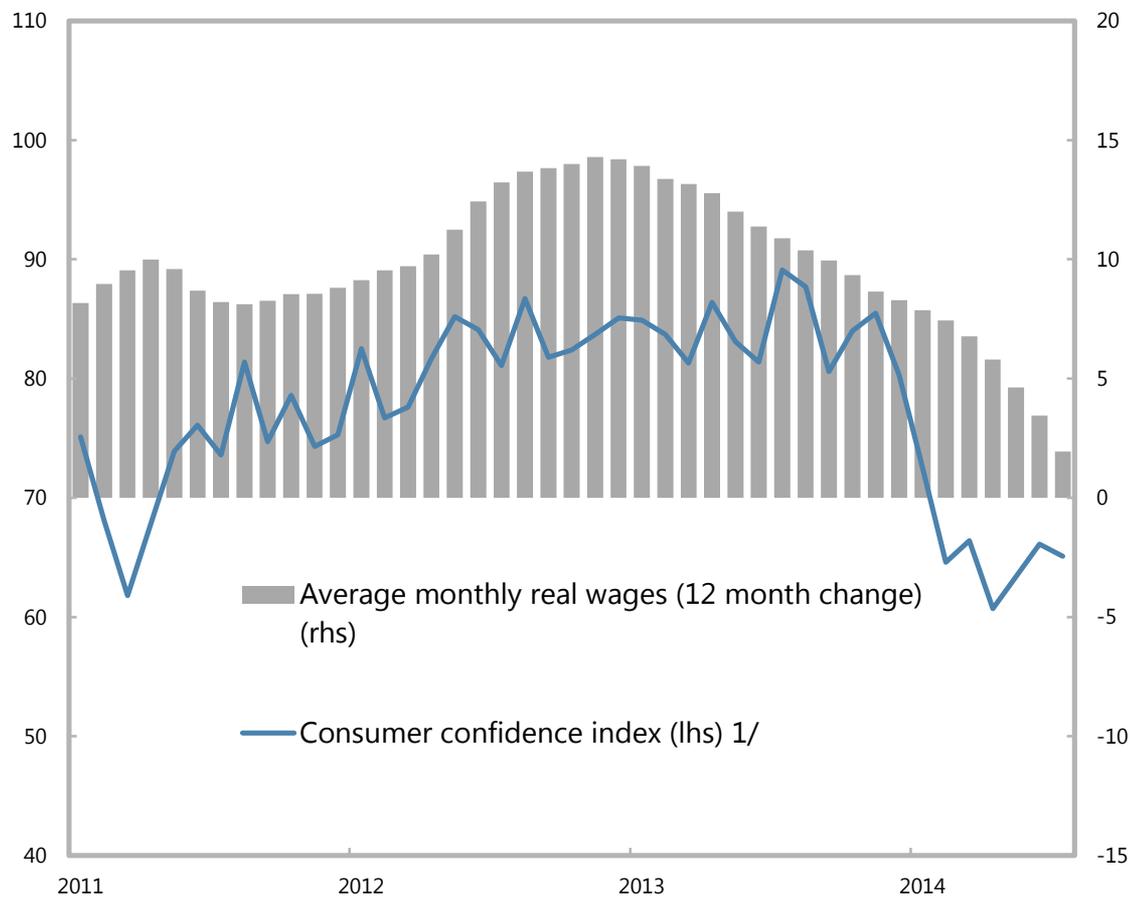
However, steel production rebounded in 2014, despite lower prices and weak demand in Russia.





Domestic demand and confidence are deteriorating

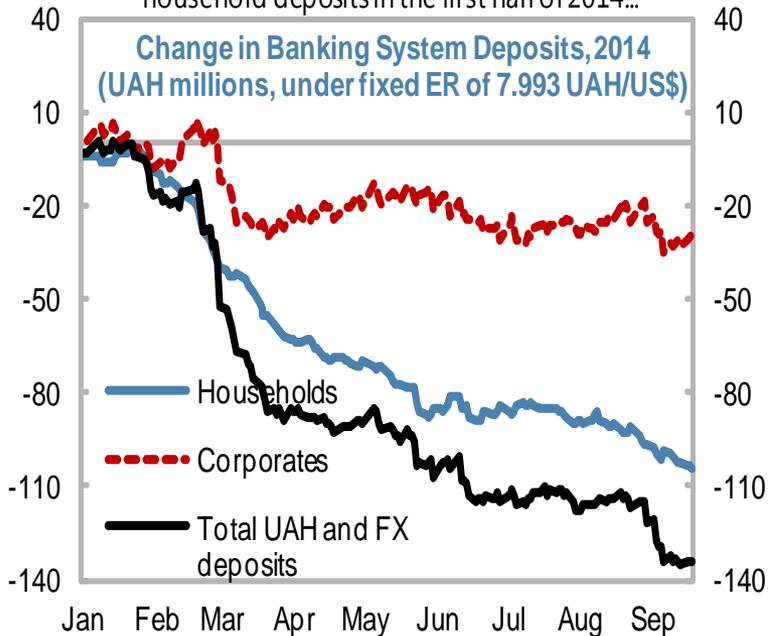
Real Wages and Consumer Confidence



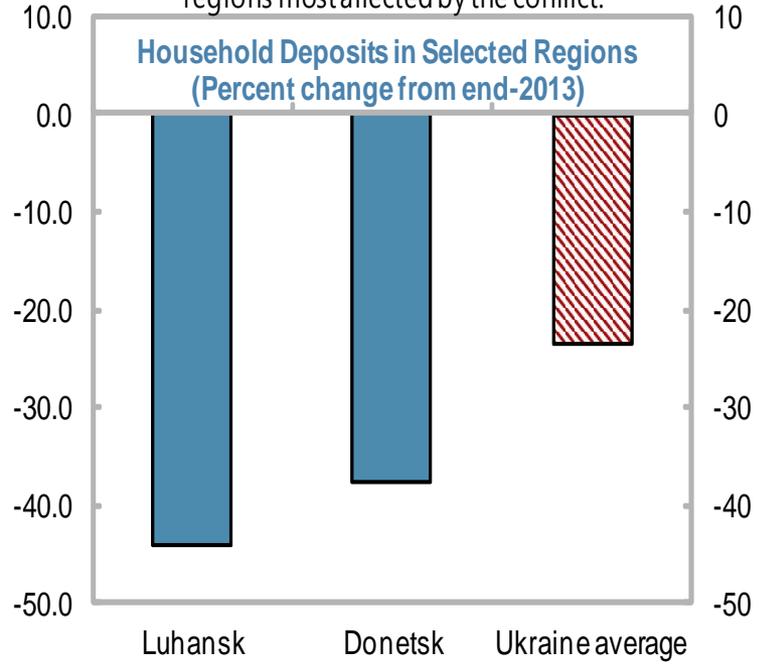


Drop in deposits has been more pronounced

The political turmoil triggered steady outflow of household deposits in the first half of 2014...



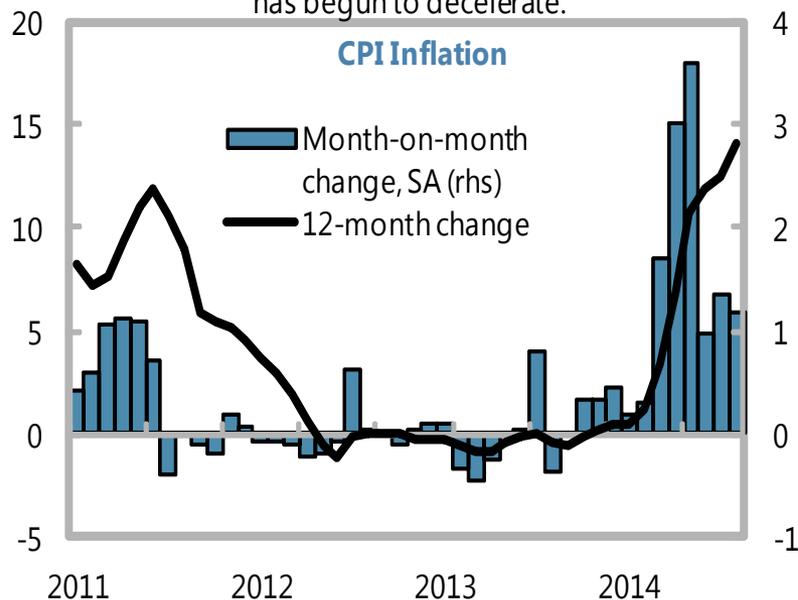
... with the heaviest outflows observed in the regions most affected by the conflict.



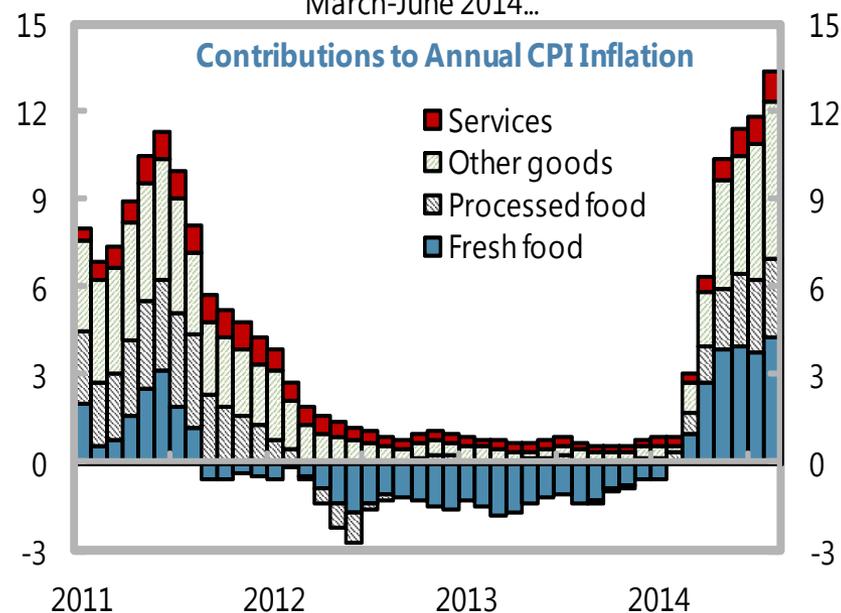


Inflation has increased

After an initial strong pick-up, headline inflation has begun to decelerate.

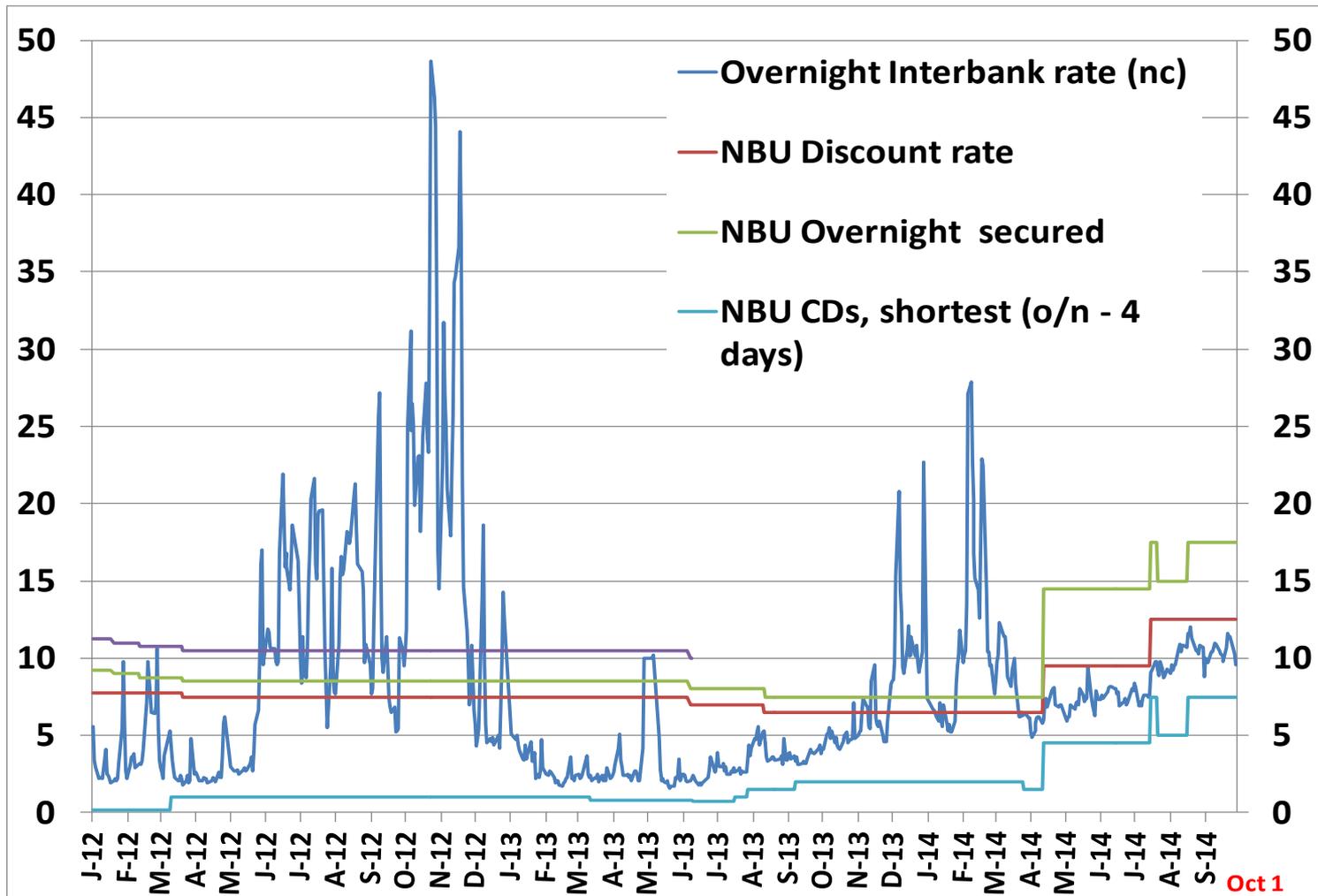


Broad-based price increases pushed inflation up in March-June 2014...





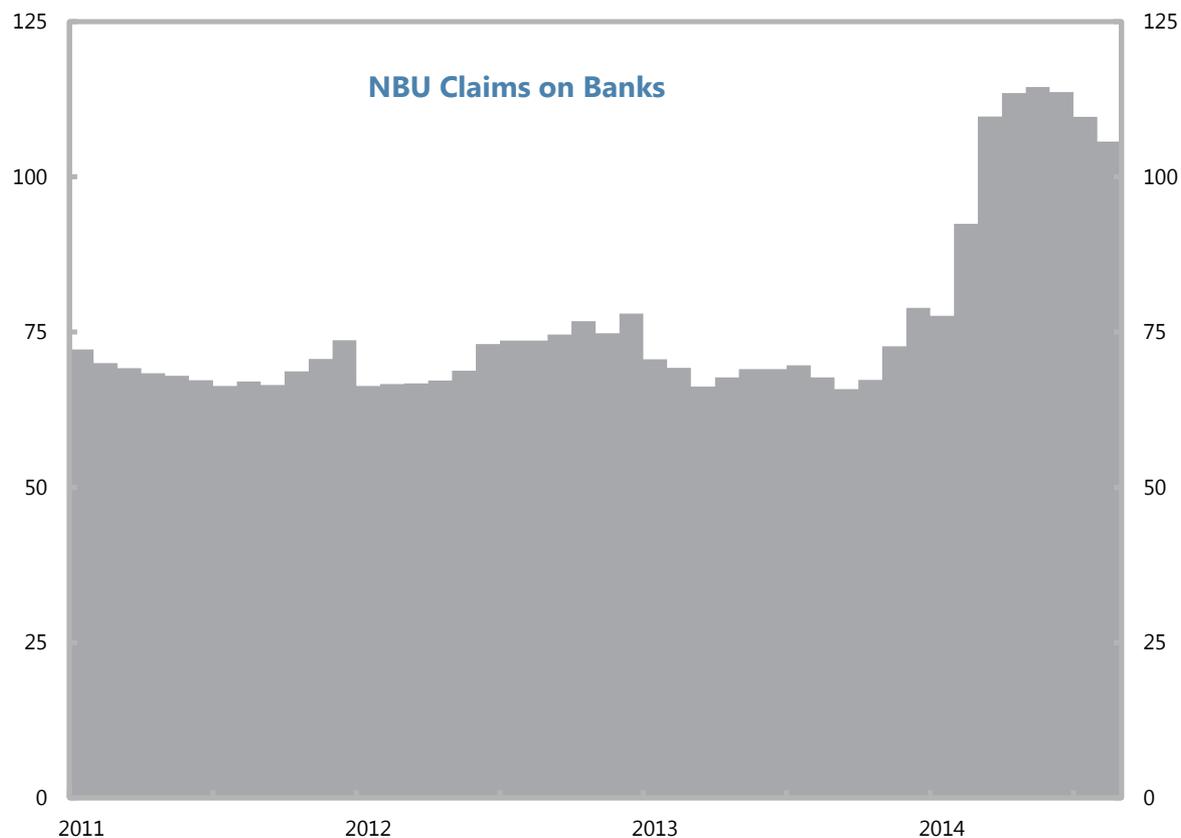
NBU has adjusted its policy rates





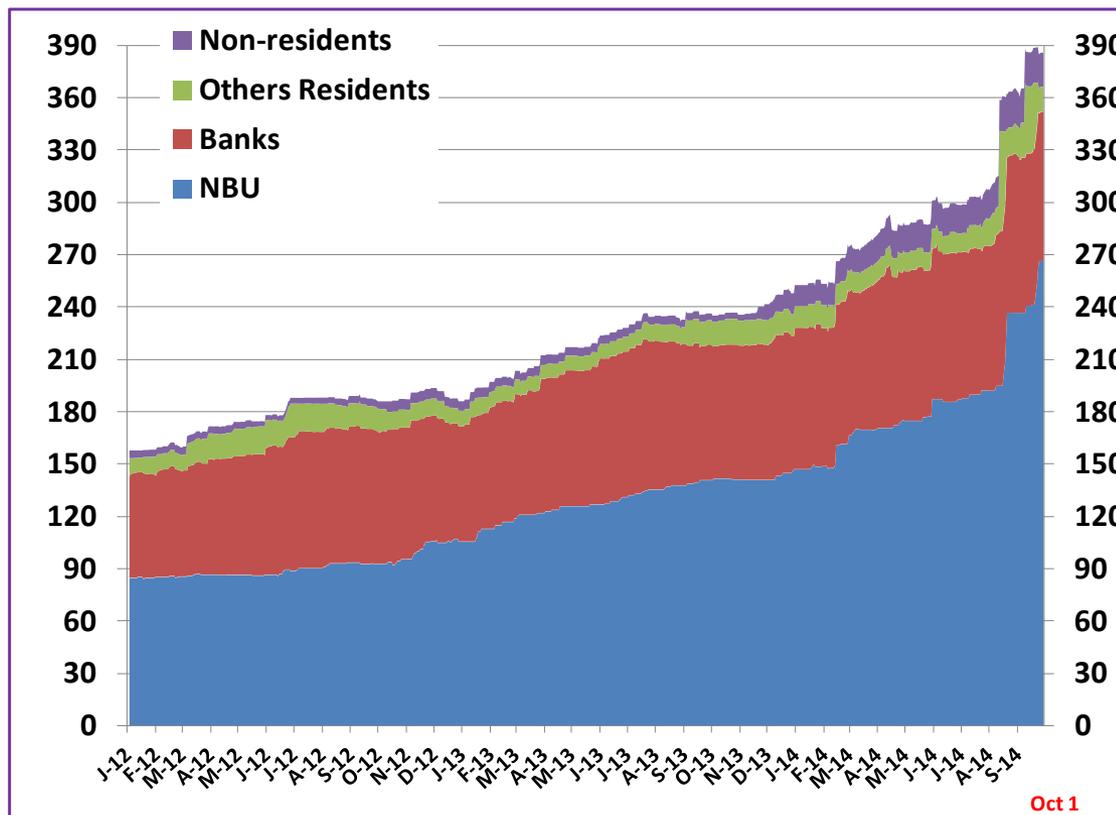
NBU provided liquidity support to banks

In early 2014, NBU provided massive liquidity support to banks experiencing deposit outflows.





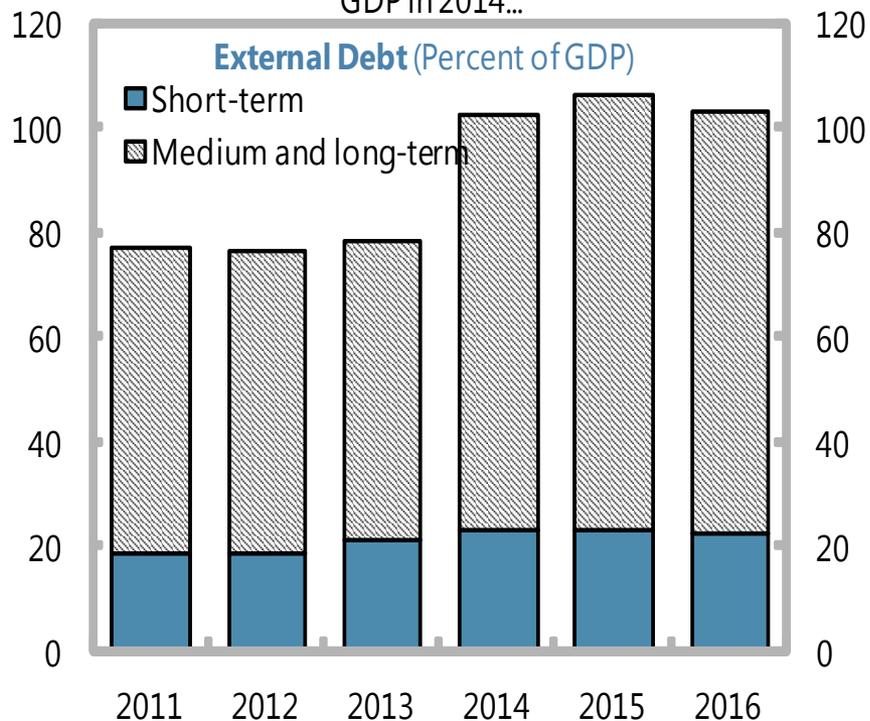
NBU's role as dominant holder of domestic debt expanded



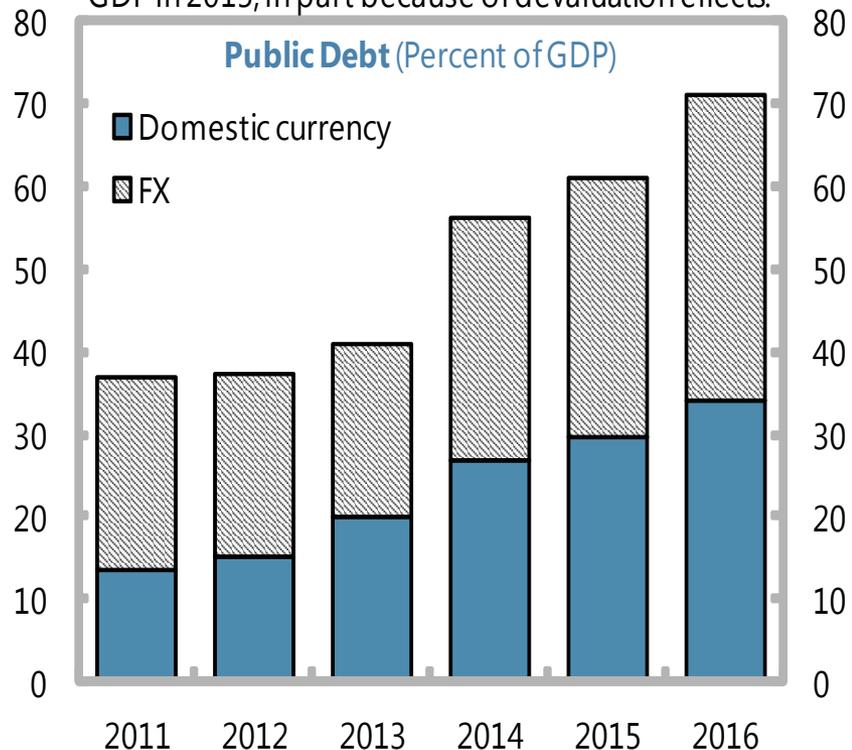


Public debt is increasing at a quicker pace...

External debt is projected to exceed 100 percent of GDP in 2014...



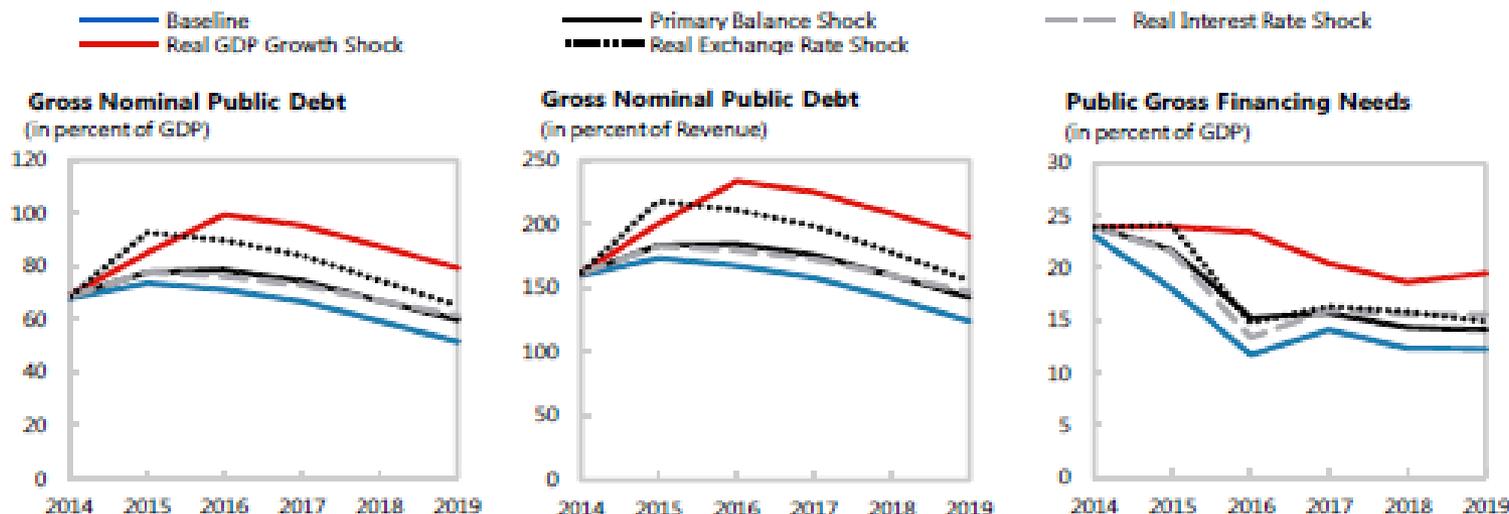
...while the public debt will exceed 70 percent of GDP in 2015, in part because of devaluation effects.



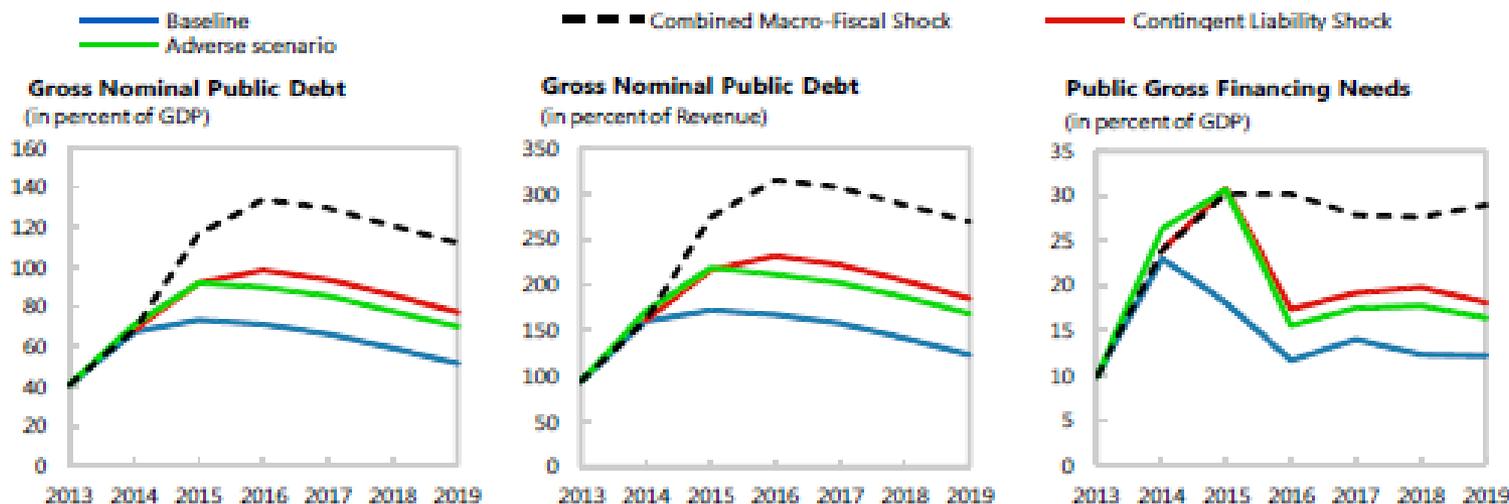


...though remains sustainable over the medium term

Macro-Fiscal Stress Tests



Additional Stress Tests





Policy response (1st Review)

1. Policy response to shocks in 3 main areas:
 - Fiscal
 - Fx and monetary policies
 - Energy
2. Combined with intensified efforts on:
 - Financial sector strengthening
 - Business environment and anti corruption



Policy response (1st Review)

- Fiscal policy response:
 - Larger budget deficit target in 2014
 - Fiscal package (August)
 - Stronger structural fiscal adjustment over 2014-2016
 - More conservative stance toward potential fiscal costs:
 - Financial sector
 - Naftogaz



Policy response (1st Review)

- Fx and monetary policy response:
 - Program path for the NBU's international reserves revised downwards
 - NBU limiting the decline in reserves through market purchases
- Naftogaz:
 - Stepped up collection of receivables
 - Set aside of funds for arrears resolution

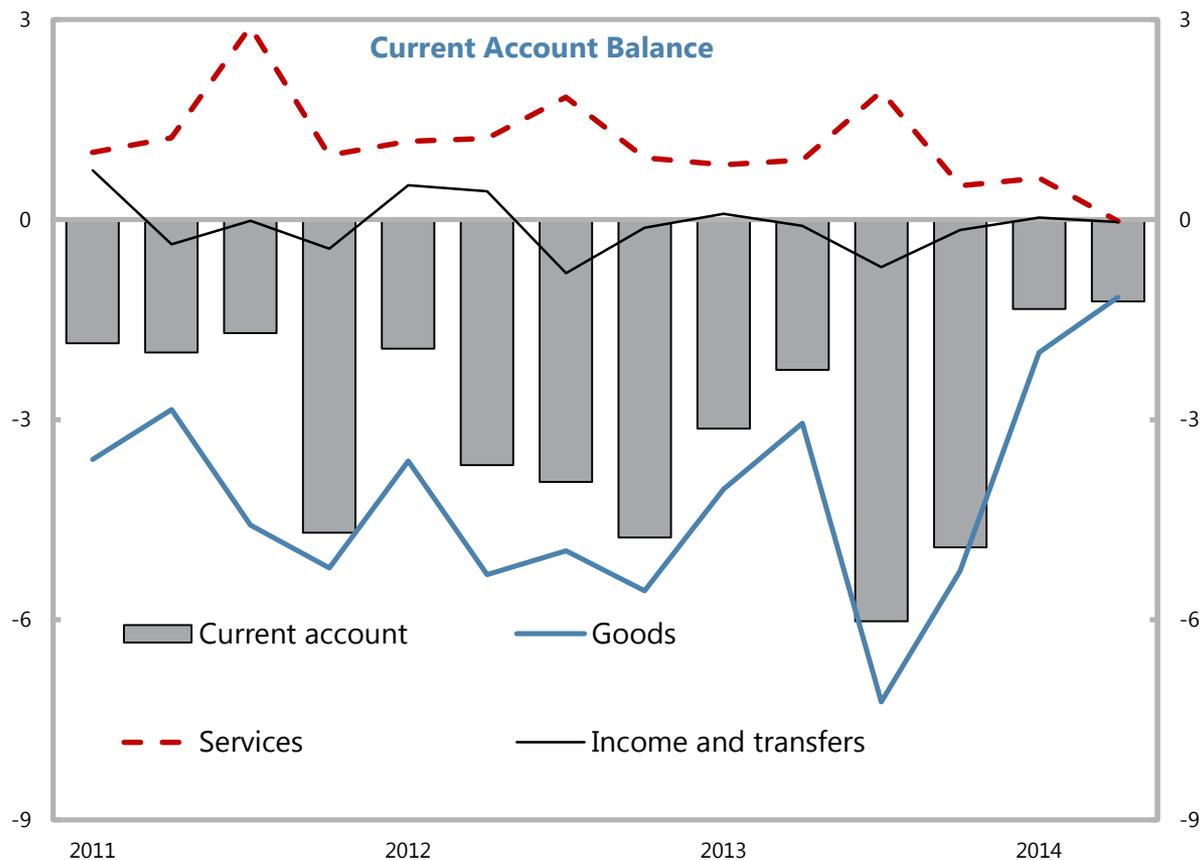


Ongoing developments

- Ongoing current account adjustment
- Episodes of exchange rate volatility and lack of confidence in the banking system
- Security developments continuing to drive market volatility and access

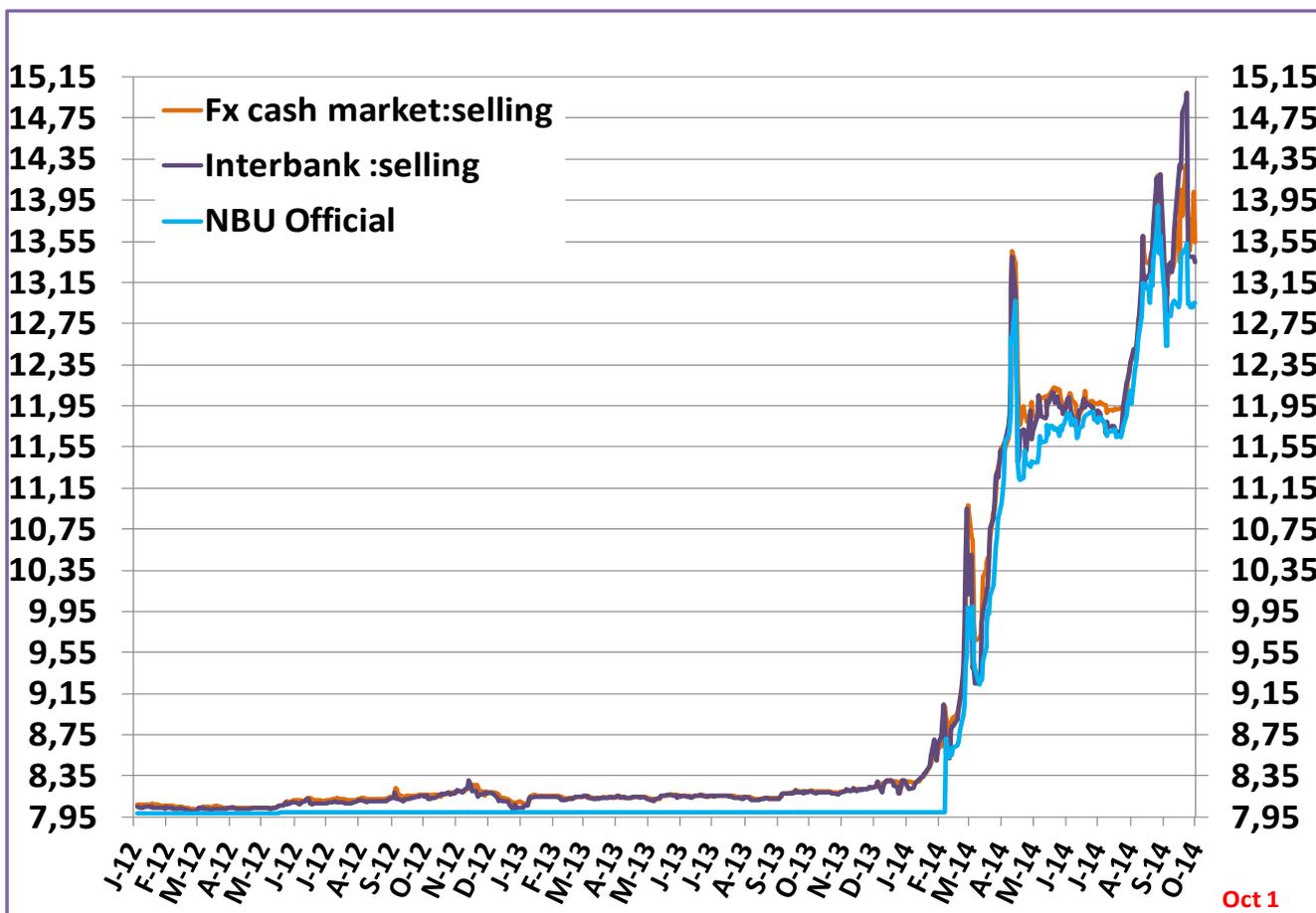


Current account is adjusting





Fx market continues to be affected by volatility

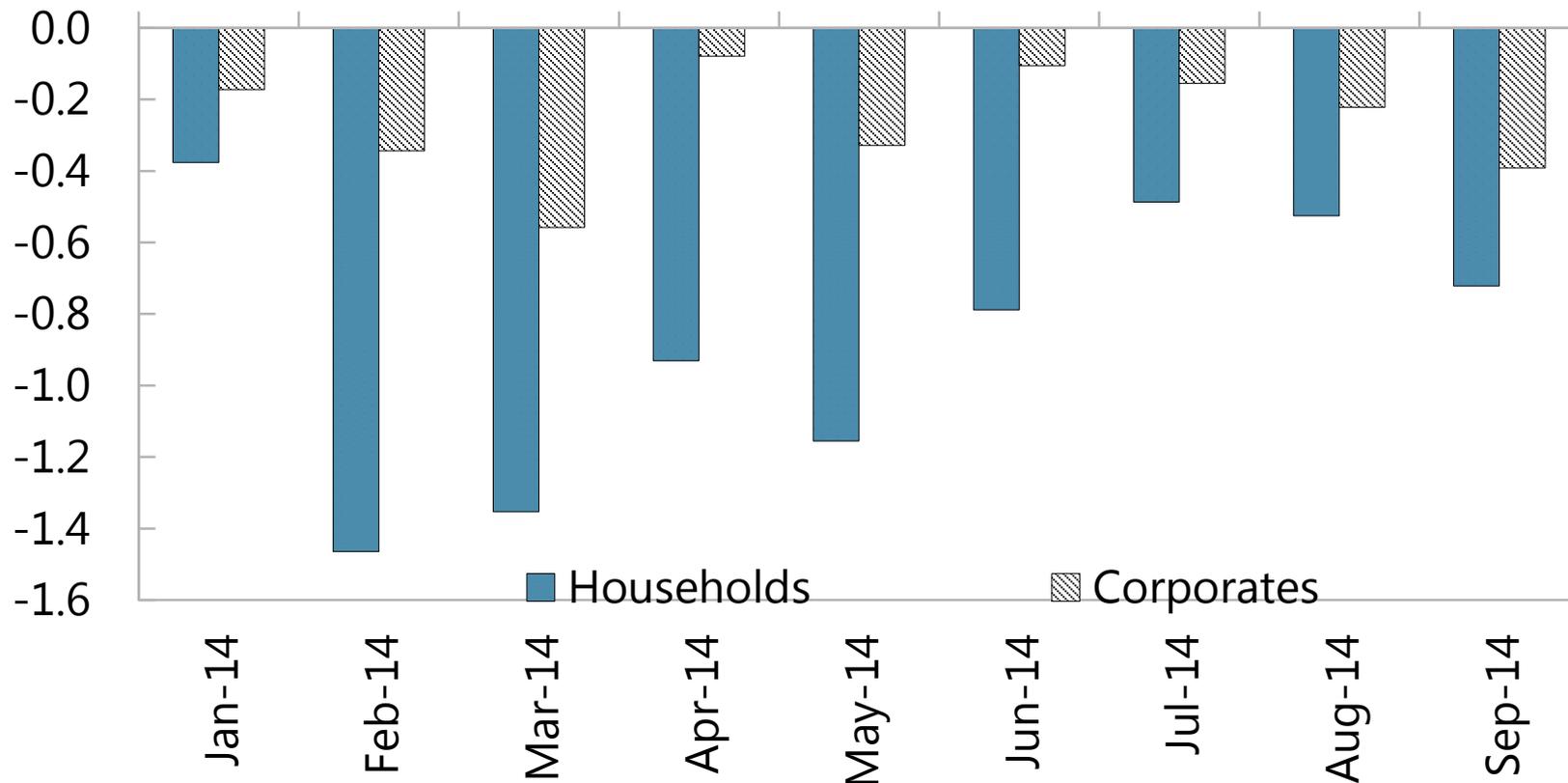




Foreign exchange deposits are still declining

Monthly Change in Foreign Exchange Deposits

(in billion of US Dollar)

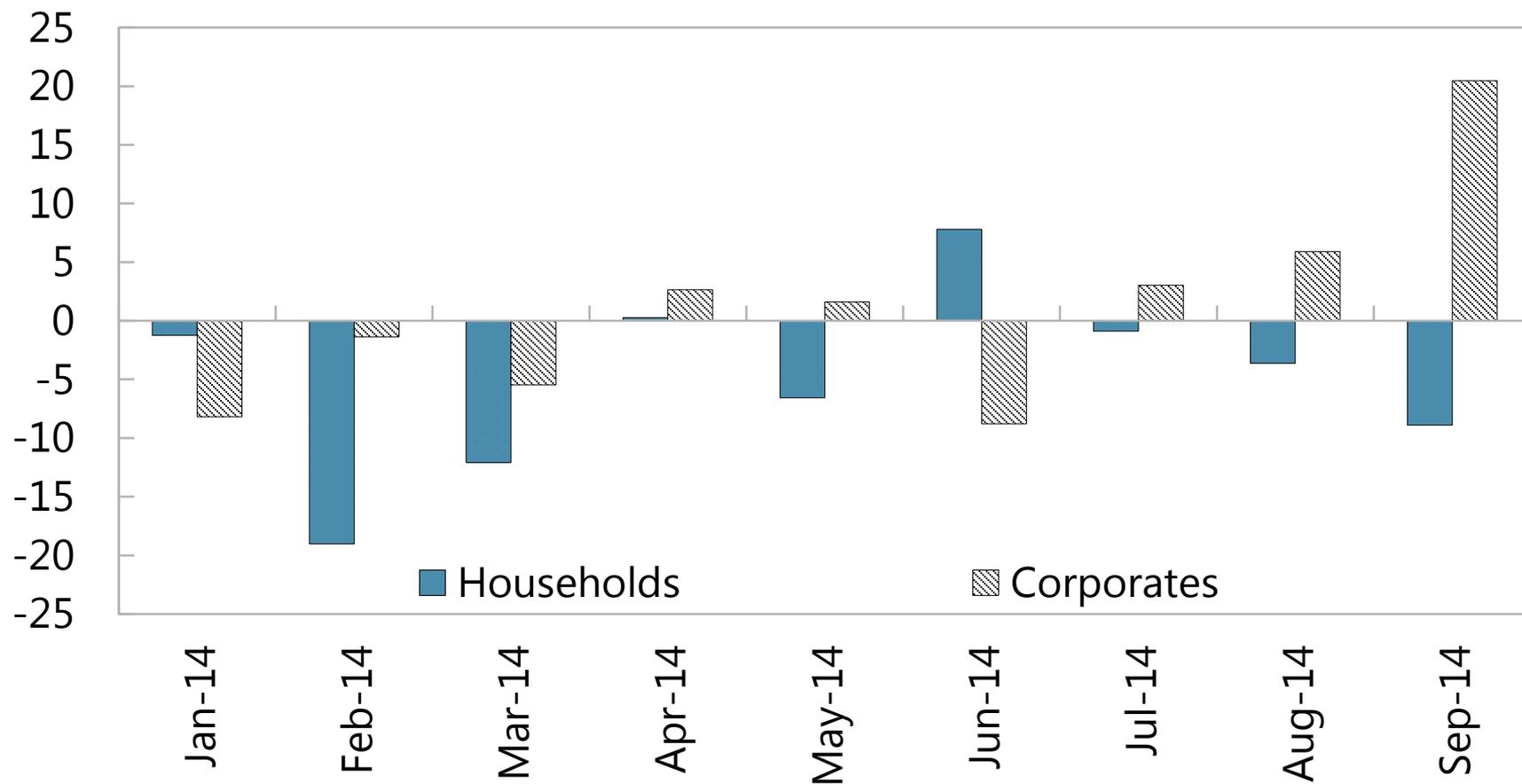




Domestic currency deposits have held up better

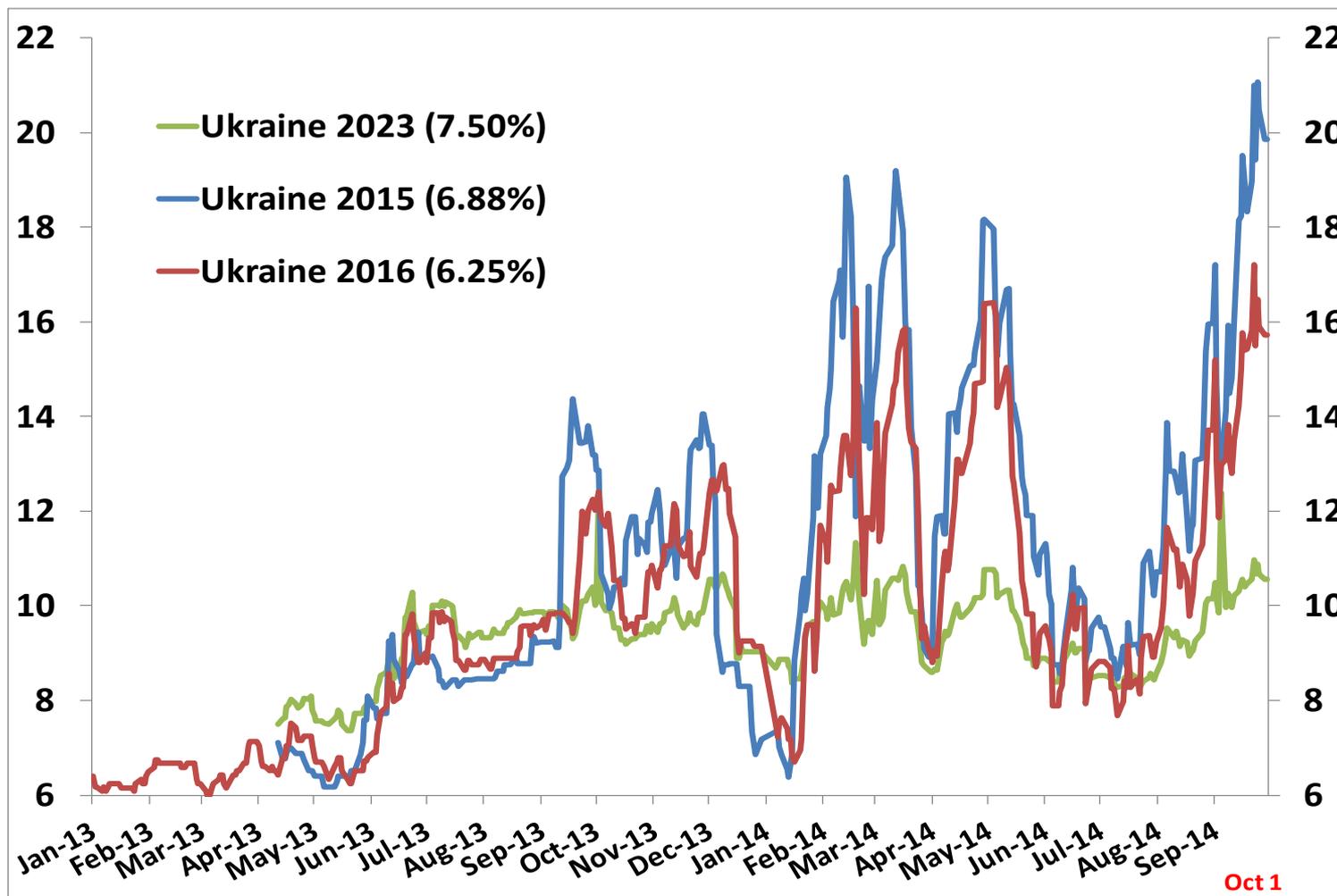
Monthly Change in Hryvnia Deposits

(in billion UAH)



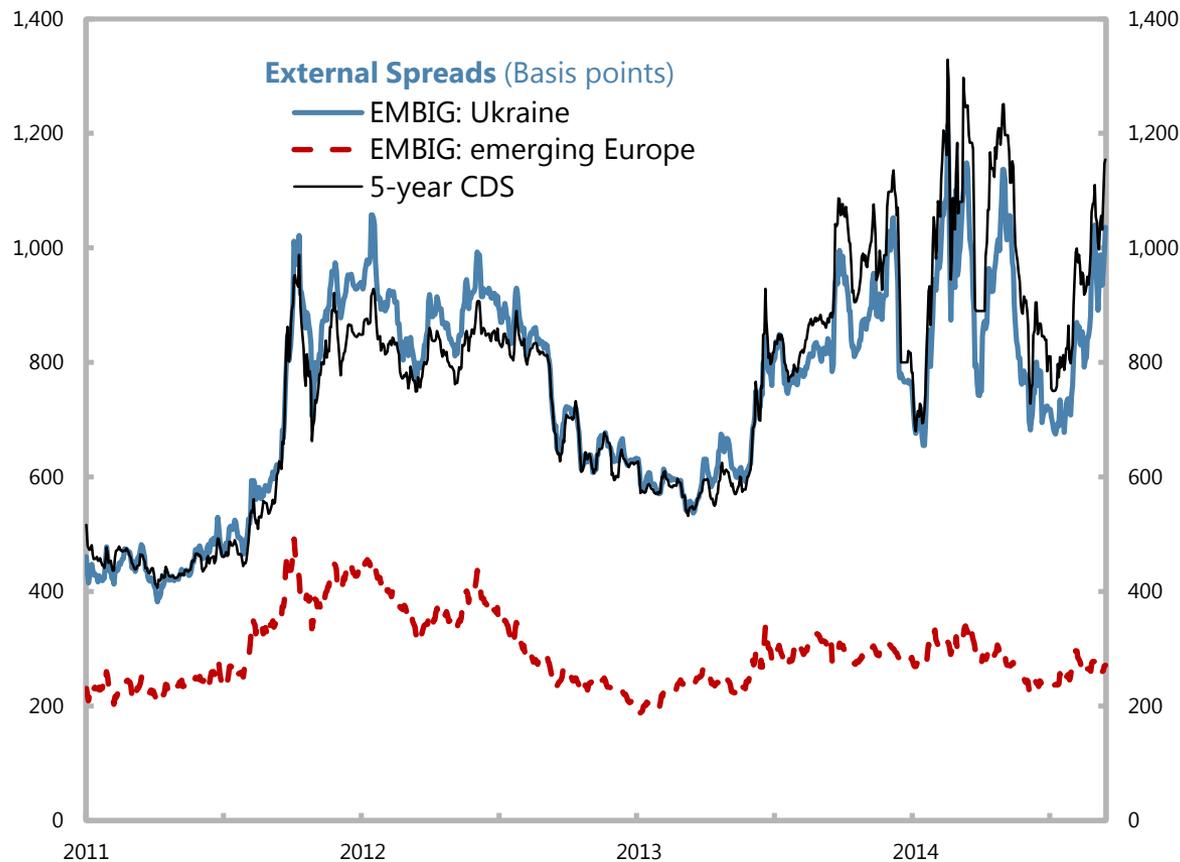


With high volatility, market access remains difficult





With high volatility, market access remains difficult





Risks are largely on the downside

1. Extension or worsening in geopolitical tensions
 - Tensions in the East
 - Relations with Russia
 - Gas dispute
2. Financial sector risks
3. Program ownership, domestic politics and other risks
4. Financing



Next steps

- Continuous assessment of policies and advice
- Political timeline (Parliamentary elections)
- Some critical discussions expected in Parliament e.g.:
 - Anti corruption
 - 2015 budget (not yet submitted)
- Combined reviews by the end of the year



Conclusions

- A critical and challenging reform program for Ukraine
- Commitment, program ownership and maintaining the reform momentum will continue to be key
- Support of reforms by the international community also fundamental
- Crisis should be used as a unique opportunity to reform



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

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

Thank you!