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NEWSLETTER

German Economic Team

UKRAINE

Finally progress on the IMF programme

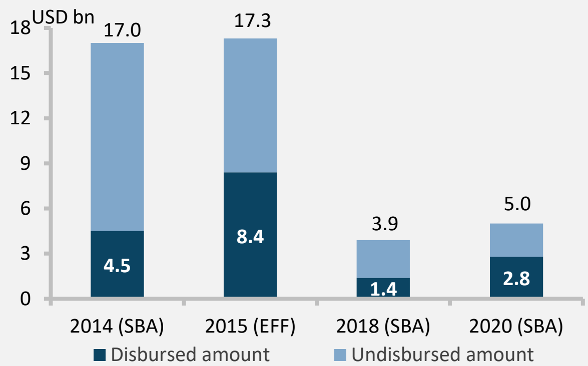
On 22 November, the IMF Executive Board approved the second disbursement of USD 700 m to Ukraine and an extension of the current Stand-By Arrangement (SBA) to June 2022. After 16 months without progress since signing the agreement and receiving the first tranche in June 2020, the first review was now successfully completed. Delayed reforms and setbacks on the independence of the National Bank (NBU), the governance of state-owned enterprises and the anti-corruption agenda were the main reasons for the delayed review. The recent breakthrough was achieved because Ukraine adopted legislative amendments to the Law on the National Bank to strengthen its independence, restored the effectiveness of anti-corruption institutions and passed a prudent budget.

There are still USD 2.2 bn left under the extended programme, which are set to be disbursed in two more tranches, contingent on further important structural benchmark reforms. The IMF programme is important as an anchor for further reforms, a cheap source of financing and a key enabler for access to international financial markets as well as for lending by other IFIs. Therefore, first promises by Ukrainian decision makers to continue the cooperation with the IMF beyond the end of the current programme are important signs.

Background: four IMF programmes since 2014

In June 2020, the IMF and Ukraine agreed on an 18-months SBA of USD 5 bn including a first tranche of USD 2.1 bn as Ukraine faced an economic and health crisis during the start of the pandemic. The current SBA is the fourth IMF programme for Ukraine since 2014. It is worth mentioning that in the previous programmes, the full amount was never disbursed.

IMF programmes since 2014

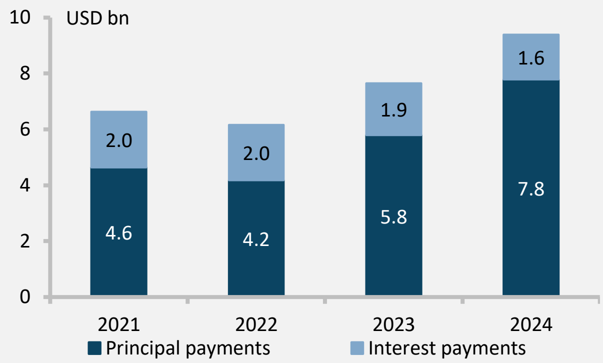


Source: IMF

16 months of delayed reforms and setbacks

For the first 16 months of the current programe, it seemed that no progress would be achieved. When agreed in June 2020, the programme foresaw reviews to take place in September and December 2020. During this time however, Ukraine's authorities backtracked in their commitments to a strong and independent NBU and the anti-corruption framework. The weakening of corporate governance and setbacks on energy policy were further reasons for the pause within the programme. Thus, servicing its external debt of USD 6.6 bn in 2021 (with a peak of USD 3.1 bn in September) was challenging without programme financing but was ensured with accumulated reserves and by using half (ca. USD 1.4 bn) of the general SDR allocation as well as ca. USD 1.4 bn from the EU's macrofinancial assistance. In 2022, Ukraine will face similar external debt service obligations, which will increase over the coming years.

External debt service



Sources: NBU, Ministry of Finance, IMF, own calculations

In this context, the IMF and Ukraine announced on 18 October that a staff-level agreement was reached on policies to be addressed for a successful completition of the review. Prior actions consisted of strengthening the de-jure independence of the NBU and of the National Anti-Corruption Bureau of Ukraine (NABU), legislative amendments on the Deposit Guarantee Fund (DGF) as well as on bank supervision, restoring obligations for public officials to submit asset declarations and adopting amendments on the Law on the High Council of Justice (HCJ). All of these six prior actions as well as a few structural benchmarks were met now. As a result, the IMF Executive Board approved the second disbursement of USD 700 m and the extension of the programme by six months to June 2022, leaving space for two further disbursements of USD 700 m and ca. USD 1.5 bn, respectively.

For Ukraine, being on track is important for three reasons: Firstly, the programme provides loans with lower interest than bonds issued on the international capital markets. Secondly, the IMF acts as an anchor for Ukraine's access to other sources of financing as it ensures policy credibility for investors as well as support by IFIs and the EU. Thirdly and most importantly, the

IMF supports Ukraine on its reform path which is undoubtedly needed to accelerate growth and converge to peers countries. Therefore, the extension of the programme is an important opportunity to facilitate reforms.

Next steps

For the upcoming reviews, Ukraine has committed to a number of structural benchmarks, as the table below shows in more detail. The recently passed budget for 2022 with a deficit of 3.5% of GDP is one of the structural benchmark for the next review (planned in March 2022), which is a promising sign.

Schedule of structural benchmarks within the programme

Schedule	Structural benchmarks
Nov-21	• Approve budget with general government deficit 3.5% of GDP (met) • Restoring eligibility criteria for officials of state-owned enterprises • Approval of succession plan for governance of SOBs
Dec-21	• Audit on COVID spending • Action plan to improve professional capacity of bank supervision in NBU • Publication of reports on criminal proceedings against former bank owners
Jan-21	• Privitisation roadmap for PrivatBank and Oschadbank
Feb-21	• Action plan/strategy paper on asset recovery
Mar-21:	• Amendments to SAPO law • Consumer database for gas suppliers
Mar-21: Possible second review/tranche of USD 0.7 bn	
Apr-21	• One-off integrity check of HCJ members by the Ethic Council
May-21	• Supervisory Board for Energoatom
Jun-21: Possible third review/tranche of USD 1.5 bn	

*Source: IMF, *SAPO=Specialised Anti-Corruption Prosecuter's Office.*

Quasi-fiscal risks stemming from the energy sector (e.g. due to not cost-covering tariffs) will be addressed through structural and quantitative conditionality. The proposed audit of fiscal spending related to COVID shows the importance that the programme attaches to fiscal issues. The proposed audit of fiscal spending related to COVID shows the importance that the programme attaches to fiscal issues. Similar provisions are foreseen to address corporate governance and other issues in state-owned banks (SOBs) and the professional capacity of the NBU.

Other important commitments relate to the rule of law/anti-corruption framework as well as to reforms in the energy sector. Of course, this assumes that there are no attempts to roll-back previous reform commitments, i.e. something similar to what happened in the months after the initial programme approval in mid-2020. Thus, it is of vital importance that the authorities demonstrate stronger programme ownership than in the past.

Conclusion and Outlook

The recently passed review and the simultaneous programme extension mark an important milestone in Ukraine's collaboration with the IMF. In a period of increased geopolitical tentions as well as an uncertain and shallow economic recovery from the pandemic, these areas of cooperation are encouraging. Looking ahread, the priorities must be twofold for Ukraine's decision makers. Firstly, there are two more reviews under the current programme, which should be tackeled and passed in a more smooth way than the first review. Secondly, Ukraine should think about a follow-up arrangement with the IMF to anchor the structural reform agenda. The mentioned shallow recovery, and relatively moderate medium-term real growth rates of slightly above 3% p.a. show that structural reforms to boost growth are needed more than ever. Supporting such a reform agenda with a new medium-term IMF arrangement would be a wise move.

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