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NEWSLETTER
UKRAINE

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The new IMF programme for Ukraine

On 31 March, the IMF approved a new 4-year Extended Fund Facility (EFF) programme with a financing volume of USD 15.6 bn for Ukraine. This follows a series of shorter engagements with the Fund after the war broke out last year. Adopting a new multi-year programme for a country subject to a full-scale invasion is also a new experience for the IMF, which openly communicates the substantial financial risks to the Fund of such a constellation, and which obtained adequate financial assurances from some of Ukraine's key international partners in that regard.

As in every programme, it comes with conditionality attached, which is focused on ensuring macro-financial (especially fiscal) stability during the war and enhance long-term growth perspective and at the same time pave the way closer to EU accession.

The role of the Fund in supporting Ukraine goes way beyond its financing role – the USD 15.6 bn are a relatively small part in comparison to the USD 115 bn in total support currently pledged to Ukraine. Still, the economic and financial experience of the Fund, its conditionalities as well as coordination position at the intersection between the international partners and Ukraine make its contribution to Ukraine resilience and recovery so unique.

IMF policy towards Ukraine since the full-scale war

Right after the beginning of Russia's full-scale invasion, Ukraine and the IMF agreed to cancel the then ongoing Stand-by Arrangement designed during the COVID crisis in favour of providing critical financial support under the Rapid Financing Instrument. Ukraine received an immediate disbursement of USD 1.4 bn in March 2022. A second disbursement of USD 1.3 bn was related to the newly created "Food Shock Window" in October 2022. Upon request of Ukraine's government, a Programme Monitoring with Board Involvement (PMB) was established with the IMF in December 2022. The PMB did not include financial support, but monitored economic policy making for four months and ultimately paved the way to a full-fledged programme, which was approved by IMF management on 31 March 2023.

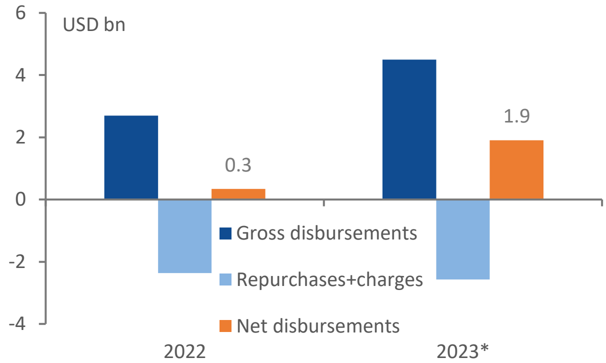
New programme with a two-phase approach

The newly adopted EFF tries to support Ukraine's authorities in stabilizing the economy as the war continues, but also in embarking on a broader set of reforms to drive the economic recovery once war is over. As significant financial risks arise from lending to an economy in a full-scale war, the IMF received assurances by the G7 and a number of EU countries regarding Ukraine's ability to service its debt to the Fund.

The EFF will run over 48 months, with an overall loan volume of USD 15.6 bn, and is split into two phases. The first one concentrates on anchoring macrofinancial stability during the ongoing full-scale war. It includes Ukraine's effort to increase revenues, support disinflation, exchange rate and financial stability. The second phase considers more structural reforms in a post-war environment when Ukraine can focus more intensively on them and the reconstruction process against the background of an EU accession path.

After the Board approved the programme, a disbursement of USD 2.7 bn was provided in the beginning of April 2023. Two further disbursements are scheduled for later this year if Ukraine meets the programme targets. However, given Ukraine's debt repayments to the IMF, net disbursements sum up to a maximum of USD 1.9 bn.

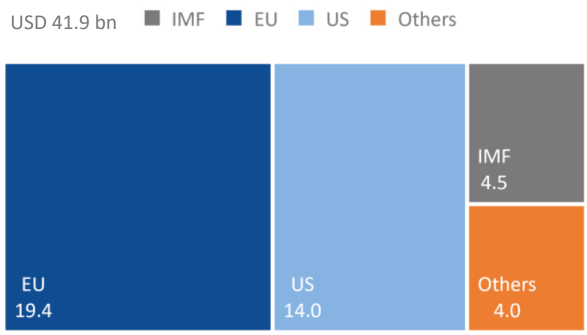
IMF disbursements gross and net



*Source: IMF, *projection of maximum disbursement*

The IMF highlights the very large uncertainty in the war environment by providing a baseline economic growth forecast with a range of -3% to +1% yoy instead of a typical point estimate for 2023. Also, a downside scenario is explicitly considered. In the baseline, inflation is forecast to decelerate to 21.1% yoy. A continuation of blocked logistics for some important export goods leads the current account into deficit. Overall, the lack of economic recovery and continued military efforts remain the driving forces behind a large budget deficit. In the baseline scenario, the IMF estimates it to rise to 28.2% of GDP (excluding grants), even larger than in 2022. In the downside scenario, a further economic decline by 10% with inflation increasing to 27.6% is projected. In this case, the budget deficit reaches 35% of GDP (excluding grants) – a massive burden for Ukraine and its partners. In light of these scenarios for the fiscal needs, disbursements by the IMF play only a minor role in closing the fiscal gap.

Projected financing of the fiscal gap 2023



Sources: IMF, Ministry of Finance Ukraine

The EU committed financial aid amounting of USD 19 bn throughout the year with USD 4.8 bn already provided and the US USD 14 bn, with USD 3.5 bn already provided. Overall, the IMF estimates that USD 115 bn are pledged in support of Ukraine until now.

Programme success depends on five principal criteria

Nevertheless, the IMF programme with its conditionality is a key reform anchor. The programme sets the focus on five principal criteria:

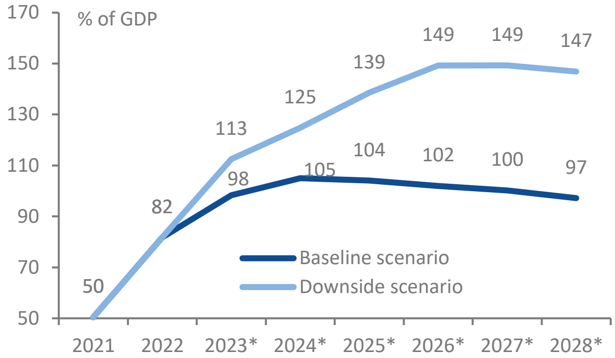
– Fiscal transparency and revenue increase
– Financing strategy and debt sustainability
– Monetary and exchange rate policy
– Financial sector and banking policy
– Governance, anti-corruption reforms and growth.

These conditionalities try to ensure macro-financial stability during the war and enhance long-term growth perspective and at the same time pave the way closer to EU accession. It is split into three prior actions as well as 19 structural benchmarks and monitored throughout eleven reviews until March 2027. Each of the successful reviews will enable further disbursements under this programme. Thereby, most of the reviews will focus on fiscal and debt sustainability issues.

Debt sustainability

Under the IMF's macroeconomic scenarios, public debt will continue to grow, after having jumped from 50% of GDP to 82% of GDP in 2022 due to the war. Against this background, it is not a surprise that debt is considered unsustainable under all scenarios, unless there is additional financial support on highly concessional terms and including debt restructuring. The concrete form and the details of this restructuring are not specified, and should be worked out at a later stage when there is more certainty regarding the economic outlook.

Medium-term projections of public debt



*Source: IMF, *forecasts, before restructuring*

Outlook

Supporting a country subject to an external full-scale aggression economically and financially is a new role for the IMF, and the exceptional high risks around the programme are clearly mentioned and communicated. Still, it's a risk worth taking. The new multi-year programme with the IMF will play a prominent dual role as a catalyst for continued international support for Ukraine, as well as for further economic reforms necessary to maintain macroeconomic stability during the war and achieve a sustainable economic recovery of Ukraine after the war has ended. In that sense, the role of the Fund goes far beyond what its financing share in the total support package for Ukraine would suggest. Leveraging its vast economic and financial experience and coordinating the efforts of many other international partners will be a main tasks ahead.

Financed by the Federal Ministry for Economic Affairs and Climate Action, the German Economic Team (GET) advises the governments of Ukraine, Belarus*, Moldova, Kosovo, Armenia, Georgia and Uzbekistan on economic policy matters. Berlin Economics has been commissioned with the implementation of the consultancy.
**Advisory activities in Belarus are currently suspended.*

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