

The Interview of Mr. Vahram Stepanyan, IMF Resident Representative in Ukraine, to Novoye Vremya Weekly (translation)

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- 1) *In November, Ukraine received a long-awaited \$700 million tranche from the IMF. According to the plan, it should have been received earlier. Why did this happen only now and to what extent does it reflect the IMF's approval of the current economic policy of Ukraine?*

First, thank you for the question and for the opportunity to discuss the IMF program. The current program was approved in June 2020 with its first review scheduled for September 2020. However, a number of events shortly after the program approval put into question the authorities' commitment to uphold the independence of the National Bank of Ukraine, and there were several critical setbacks to the anti-corruption framework. These required a pause to assess policy continuity and to determine possible corrective actions.

Since then, the authorities have taken important corrective actions to address these shocks to program objectives and deliver on delayed program benchmarks, and this, together with new commitments by the authorities in key policy areas, allowed the completion of the first review and the disbursement of funds.

Regarding the government's economic policies, our assessment is that the Ukrainian authorities' program was successful in providing budget financing to allow for a looser fiscal stance and a liquidity buffer by boosting reserves. This allowed the authorities to deploy a stronger policy response to cushion the economic and social impacts of the COVID-19 pandemic while preserving macroeconomic and financial stability.

The policy framework agreed under the program as well as the resources available under the program should help Ukraine manage the challenging and uncertain global and domestic environment. In this regard, the authorities' strong ownership as well as full and timely implementation of agreed reforms will be paramount.

- 2) *When and under what conditions can Ukraine expect the next tranches from the IMF under the Stand-By Arrangement? This depends not only on the willingness or unwillingness to implement economic and political reforms, but also on the execution of the State budget, doesn't it?*

The current design of the program has two more reviews scheduled for March and June of 2022, and successful completion of those reviews would pave the way for disbursement of SDR 0.5 billion and SDR 1.1 billion, respectively.

As I already mentioned, the published program documents provide the details of the authorities' policy commitments as well as specific measures and quantitative targets that need to be achieved under the program. And the budget execution and fiscal indicators form key parts of the agreed macroeconomic program and targets.

The authorities' policy commitments could be summarized as follows: (i) returning fiscal policies to settings consistent with medium-term debt sustainability while protecting the socially vulnerable, strengthening revenue administration, and reducing fiscal risks from quasi-fiscal operations; (ii) safeguarding central bank independence and focusing monetary policy on returning inflation to its target; (iii) ensuring health of the financial sector; (iv) tackling corruption and pushing forward with the implementation of judicial reform; and (v) reducing the role of the state and vested interests in the economy to improve the business environment, attract investment and raise the economy's potential.

- 3) *Economic recovery in Ukraine this year has not been happening at the pace that everyone expected, say, six months ago. There were hopes that at least in 2021 Ukraine would take a more positive economic trajectory. But the IMF lowered the GDP forecast for Ukraine from 3.5% to 3.2% for this year. Why?*

After a rebound in the second half of 2020, the economic recovery stalled in 2021, but is expected to pick up in the second half of 2021 on the back of stronger consumer demand and a recovery in agriculture. Even though the effects of the COVID crisis linger into 2021, we expect a positive real growth of about 3.2 percent. Our growth projection was recently downgraded from 3.5 percent, as you mentioned, related to weak economic performance in the first half of the year. Recently released Q3 flash GDP estimates indicate that GDP has returned to growth and output is now only slightly below its end-2019 level. But, as I mentioned earlier, the outlook remains uncertain, including from resurgence in infections, as vaccination rates, while rising recently, remain low. This puts a premium on good policies – ensuring macroeconomic stability and targeting government fiscal interventions carefully for maximum growth impact per taxpayer resources spent.

- 4) *Another interesting point in the memorandum is the future of Energoatom, a state-owned holding company that produces nuclear electricity. Why has the IMF got interested in Energoatom's financial indicators and offered to privatize this structure?*

First, a clarification: commitments under the IMF-supported program refer to corporatization of Energoatom and not its privatization.

The program includes reforms in the energy sector where quasi-fiscal deficits exist (quasi-fiscal activities are usually activities undertaken by state-owned enterprises at the direction of the government). The objective of certain measures is to strengthen financial health and increase transparency of operations of major SOEs in the energy sector including through improved governance. To this end, authorities have committed to enact

the Law on corporatization of Energoatom by end-December 2021, including a requirement to produce financial accounts according to international standards. They have also committed to establishing for Energoatom a supervisory board with a majority of independent members selected through a transparent and robust procedure by end-May 2022.

- 5) *The state energy giant Naftogaz is no less important for the Ukrainian energy sector. The memorandum envisages filling Naftogaz's accounts with state funds to cover the financial liquidity deficit. Will this not turn Naftogaz into a kind of funnel for the flow of funds from the State budget, and what should be done to prevent this from happening?*

The spike in global energy prices in 2021 led to substantial pressures on domestic fuel and utility prices, in Ukraine and across Europe. In response to a very large increase in natural gas prices, the authorities implemented measures to protect Ukrainian households and businesses. Three principles are important to consider in designing an appropriate response: one, transparency, two, targeting public support so that public money is not wasted, and, three, not distorting efficient operations of markets.

In line with these principles, the memorandum envisages transparency around the exceptional support – in other words, if exceptional and one-time support to Naftogaz is needed because, say, emergency imports of gas are needed to meet energy supply needs, then it should be recorded and budgeted for transparency. The memorandum also envisages budgeting sufficient amounts for social support, through a budget program that is considered well-targeted, meaning that public money is used to support those who truly need it. And finally, the memorandum envisages allowing for the gas market to function efficiently, with prices providing the right incentives to ensure a balance of supply and demand, avoiding overuse or undersupply.

And you are right, it is important to avoid going back to the persistent and large deficits of Naftogaz from the past. The memorandum envisages an audit and monitors the combined deficit of the government and Naftogaz under the program.

- 6) *The whole world today is concerned about rising inflation. Even in the Eurozone where price growth has traditionally been slow the figure has reached a record 4.9%. Ukraine has inflation at almost 11%. When should we expect a reduction in the inflation and what do you think the National Bank and the government should do about it?*

Indeed, inflation remains high, and not only in Ukraine but in many countries across the globe. In the case of Ukraine, inflationary pressures during this year have been high and stemmed from strong consumer demand, a rise in global commodity prices, and strong wage growth. In March 2021, the NBU started a tightening cycle of its monetary policy. We support the tightening implemented by the NBU so far and their readiness to continue tightening as needed to return inflation to the target within the policy-relevant horizon. For 2021, we project average inflation at 9.5 percent. Inflationary pressures are expected to persist into 2022, with average inflation projected at 7.5 percent. While lower commodity price inflation and tighter monetary policy are expected to return inflation to the target band by end-2022, it is important for the NBU to remain vigilant, and for the focus to remain on containing and lowering inflation to its target level.

7) *We hear a lot of statements from the Ukraine's leadership about measures that require budget financing – these include a 100 billion UAH program of thermal modernization of buildings, the presidential program of the drinking water quality, the Great Construction and the Great Restoration. In your opinion, is Ukraine and its government capable to finance such expensive programs?*

Improved infrastructure, higher energy efficiency, and better access to quality water are appropriate goals and key in achieving higher and more inclusive growth in Ukraine. At the same time, there are several important considerations before deciding on implementation of such large-scale projects. First, there is the macroeconomic stability aspect in that fiscal expenditures for financing such projects should be consistent with the program's macroeconomic framework and overall fiscal strategy of lowering public deficits and debt in the medium term. Then, given hard budget constraints and implementation risks, decisions to finance large-scale projects in these areas need to be based on proper cost-benefit analysis and careful prioritization. Also, further strengthening of governance in the public sector will be important to minimize potential waste and corruption risks.