Ms. Christine Lagarde  
Managing Director  
International Monetary Fund  
Washington DC, 20431  

Dear Ms. Lagarde:

1. In recent years, unsustainable policies and weak governance in Ukraine have led to economic stagnation and excessive fiscal and external imbalances. In early 2014, political turbulence and deteriorating consumer and investor confidence drove bank deposit outflows, a collapse of fiscal revenues, a depletion of international reserves, and rapid depreciation of the hryvnia. Recent emergency measures under the new government have led to a degree of stability, but the situation remains fragile. Substantial repayments of domestic and external debt over the next two years together with sizeable gas import payments and other pressures will impose a heavy burden on the economy and public finances.

2. The Ukrainian government is committed to a comprehensive economic reform program to restore macroeconomic stability, strengthen economic governance and transparency, and lay the foundation for robust and balanced economic growth. A sequence of near- and medium-term reforms will aim at achieving external balance, strengthening the financial sector, restoring sound public finances, rationalizing the energy sector, and improving the business environment. A number of key measures will be put in place immediately to demonstrate our commitment to program policies and objectives. These prior actions, which are described below and appear in Table 1, will address long-standing issues in monetary and exchange rate policy, the financial sector, fiscal policy, and governance. In this context, we will take steps to cushion the negative impact of reforms on the most vulnerable groups of our society. The program of the Government, that envisages the cooperation with the IMF, is supported by all major political parties.

3. We request the support of the IMF for the ambitious reforms needed to achieve our program objectives. Based on our estimated balance of payments needs, we request the approval of a 24-month Stand-By Arrangement (SBA) in the amount of SDR 10,976 million (800 percent of quota). We need financial support under the proposed SBA not only to address current account deficit and pressures on capital account but also to build up reserves. The first disbursement will be SDR 2,058 million, of which the domestic currency counterpart of Fund purchases in the amount of SDR 1,290 million will be used to finance the budget deficit.

4. We regard the policies set forth in the attached Memorandum of Economic and Financial Policies (MEFP) as adequate to achieve program objectives but will take any additional measures that may become appropriate for this purpose. We will consult with the IMF on the adoption of such
additional measures in advance of revisions to the policies contained in the MEFP, in accordance with the Fund’s policies on such consultation. We will provide the Fund with the information it requests for monitoring progress during program implementation. We will also consult the Fund on our economic policies after the expiration of the arrangement, in line with Fund policies on such consultations, while we have outstanding purchases in the upper credit tranches. Reaffirming commitment to our policy of transparency, we consent to the IMF’s publication of this letter, the attached MEFP, the Technical Memorandum of Understanding (TMU), and the accompanying Executive Board documents.

Yours sincerely,

/s/  
Oleksander Turchinov  
Acting President

/s/  
Arsenii Yatseniuk  
Prime Minister

/s/  
Oleksandr Shlapak  
Minister of Finance

/s/  
Stepan Kubiv  
Governor  
National Bank of Ukraine
Attachment I. Memorandum of Economic and Financial Policies

I. BACKGROUND AND MACROECONOMIC FRAMEWORK

1. Ukraine’s macroeconomic imbalances reached unsustainably high levels over the past year. The 2013 fiscal deficit was 4¼ percent of GDP, and the government accumulated sizeable expenditure arrears. The 2013 deficit of the state-owned gas company Naftogaz reached nearly 2 percent of GDP, driven by the sharp increase in loss-making sales to district heating companies and declining profitability of sales to industries. Public debt rose to 41 percent of GDP, while external debt remained elevated at 78½ percent of GDP. The (until recently) pegged and overvalued exchange rate drove the current account deficit to over 9 percent of GDP. With significant external payments and limited access to international debt markets, international reserves fell to a critically low level of around two months of imports. Ukraine needs financial support under the proposed SBA not only to address current account deficit and pressures on capital account but also to build up reserves.

2. Following the intense economic and political turbulence of recent months, Ukraine has achieved some stability, but faces enormous challenges. To safeguard reserves and address currency overvaluation, the National Bank of Ukraine (NBU) floated the exchange rate in February. Measures implemented in February and March helped stabilize financial markets and ensure that critical budget priority payments have been met. In this context, the NBU provided liquidity support to banks and increased its holdings of government bonds, which helped to ease government financing conditions. Nonetheless, the economic and political environment remains uncertain. With no current market access, large foreign debt repayments loom in 2014–15 (including to the IMF). Early presidential elections are scheduled for May 25, 2014.

3. Economic performance in 2014 will be mixed. Under our proposed economic reform program, the current account deficit will fall to about 4½ percent of GDP, helped by the exchange rate adjustment and fiscal tightening. Growth could contract significantly during the year, reflecting weak investor and consumer confidence, leading to the annual GDP decline of about 5 percent. Inflation will temporarily spike in response to the recent exchange rate adjustment (and also gas and heating tariff increases), reaching 16 percent at end-2014. International reserves will stabilize at around 2½ months of import coverage. The currency devaluation and official borrowing (to help finance a still-wide government deficit) is expected to push public sector debt up to 56½ percent of GDP and external debt to 99½ percent of GDP.

4. Our economic reform program, backed by support from the Fund and other partners, will boost Ukraine’s medium-term prospects. Policies will strengthen competitiveness, restrain the current account deficit to 4–4¼ percent of GDP in 2015–16, and restore public and private sector access to international capital markets. The public sector will continue to meet its obligations, and Naftogaz will meet ongoing gas import payments. Macroeconomic stabilization and structural reforms, including improvements in governance and the business environment, will strengthen
investment, raise growth, and enhance fiscal and external sustainability. Exports are projected to
growth by over 6 percent in 2015–16. By end-2016, inflation will fall to about 6 percent and the NBU
will replenish its international reserves to cover nearly 4 months of imports.

II. PROGRAM OBJECTIVES

5. Our program aims to restore macroeconomic stability, strengthen economic
governance and transparency, and lay the foundation for robust and balanced economic
growth. The policy strategy centers on near-term measures to secure stability and deeper reforms
to: durably reduce current account and fiscal deficits to ensure debt sustainability; strengthen the
policy making framework; and achieve higher, sustainable growth.

6. Official and multilateral financing will play a critical role in supporting our
stabilization, adjustment and reform efforts. In addition to IMF financing, we have secured
financing commitments from the EU, U.S., World Bank, EBRD, EIB, and other bilateral donors and
international financial institutions (IFIs). We will strive to unlock all committed bilateral and
multilateral financing and collaborate closely with international partners in key reform areas.

III. POLICIES UNDER THE PROGRAM

7. The reform program will focus on monetary and exchange rate policies, the financial
sector, fiscal payments and adjustment, the energy sector, and strengthen governance,
transparency, and the business climate.

a. Monetary policy will focus more squarely on domestic price stability, targeting 3 to
5 percent inflation over the medium-term consistent with the productivity differential with our
trading partners. The exact inflation target and range will be specified in the course of
introducing IT. In this context, the NBU will maintain a flexible exchange rate policy. Within
12 months of program approval, the NBU will adopt inflation targeting. Until then, monetary
policy will utilize the NBU’s net international reserves (NIR) and net domestic assets (NDA) to
ensure base money growth consistent with domestic price stability. We anticipate that this
approach will help bring domestic price stability, eliminate external imbalances, and facilitate
gradual rebuilding of depleted international reserves.

b. Financial sector reforms will aim to ensure financial stability. We will monitor liquidity levels
and ensure financial resilience in the banking sector, restructure and recapitalize financial
institutions in need, upgrade the regulatory and supervisory framework, and take steps to
facilitate restructuring of non-performing loans (NPLs) in the banking sector. We anticipate this
approach will boost depositor confidence and promote healthy credit growth.

c. Fiscal policy will seek to meet priority spending obligations during the coming months,
and implement deeper fiscal adjustment measures over the medium-term. The initial
stabilization in 2014 will be achieved through a mix of revenue and expenditure measures. For
2015–16, we envision a gradual expenditure-oriented fiscal adjustment—proceeding at a pace
commensurate with the economy’s speed of recovery—aiming to reduce the structural fiscal
deficit by around 2 percent of GDP by 2016. We expect this approach to achieve a fiscally sustainable position and boost confidence.

d. **Energy sector reforms will focus on reducing the fiscal drag from this sector, and enhancing its efficiency.** A key mechanism for achieving this will be gradual increases in retail gas and heating tariffs—backed by corresponding gas price hikes to district heating entities—and accompanied by enhanced social assistance measures to mitigate the impact on the poorest. We will also improve the transparency of Naftogaz’s accounts and launch the process of its restructuring. Over time, we expect these measures will also promote domestic investment and growth, increase energy independence, and reduce balance of payments pressures.

e. **Strong governance, transparency, and business climate reforms are central to our program.** We will build capacity to more effectively conduct anti-money laundering (AML) activities, anti-corruption actions, and seek recovery of stolen assets. We plan to increase transparency of government operations and address governance problems in Naftogaz and other publicly-owned institutions—and will seek out expertise from the IMF and other international partners to help achieve our goals in these areas. We expect these measures to help improve the business climate and remove long-standing barriers to growth.

A. **Exchange Rate and Monetary Policy**

8. **We are committed to maintaining a flexible exchange rate.** This will help facilitate much-needed external adjustment, preserve scarce international reserves, and provide an important shock absorber. The exchange rate adjustment implemented in early 2014 has eliminated the estimated pre-crisis overvaluation of the hryvnia and created preconditions for reducing the external current account deficit. These factors, combined with other reforms under the program, will help maintain a real exchange rate level broadly in line with fundamentals. Going forward:

a. **As the NBU’s international reserves through 2014 are projected to remain critically low despite sizable official assistance, the NBU will seek to gradually accumulate reserves through market purchases, consistent with reserve targets in Table 3.** This will help maintain market confidence that the country has sufficient foreign exchange resources for the Government to make external debt service payments and for Naftogaz to settle its gas payment arrears. Should the balance of payments turn out better than projected, the pace of reserve accumulation will accelerate. On rare occasions, the NBU may deploy well-timed but limited foreign exchange sales if needed to help contain a self-fulfilling expectations-depreciation loop.

b. **We will facilitate development of a more robust, transparent, and predictable foreign exchange market, including private-to-private hedging instruments.** This is essential to instill confidence and reduce unnecessary market costs. In this context, we will not impose any new restrictions affecting foreign exchange operations, nor intensify existing restrictions during the program period. We will request an IMF assessment of existing foreign exchange restrictions (by end-May 2014), and will formulate and begin implementing a plan for their staged removal (by end-July 2014), starting with the most distortionary controls while safeguarding macrofinancial stability.
c. **As a prior action for the IMF Board’s consideration of the SBA, on March 31, 2014 the NBU adopted a regulation specifying that the official exchange rate is calculated as a weighted average of rates on the same day’s interbank transactions.** This will further increase transparency of the official exchange rate and eliminate a multiple currency practice (MCP).

9. **Monetary policy will focus on domestic price stability in line with the NBU’s core mandate.** For the coming year, monetary policy will employ a NIR/NDA targeting framework to ensure a money supply path consistent with domestic price stability. Initially, it will accommodate some budget deficit and bank financing needs, while maintaining an appropriate NIR level. However, from mid-2014, with confidence in the banking system restored and fiscal accounts strengthened, domestic financing needs will be strictly subordinated to the primary monetary policy objective of controlling inflation. Going forward:

a. **The NBU will provide banks with greater flexibility to manage their liquidity** by abolishing daily limits on the minimum account balances held in their accounts with the NBU, and instead require banks to meet the obligatory reserve ratios on average over the monthly reserve managing period.

b. **We will abstain from using administrative regulations and restrictions** as a substitute for conventional monetary policy tools.

10. **Within 12 months of program approval, the NBU will have completed necessary technical preparations and will adopt inflation targeting (IT) as its new monetary policy anchor.** To this end, we will:

a. **Set a clear timeline (by end-June 2014) for completing the remaining preparations needed to adopt IT.** This should include measures to strengthen the NBU’s forecasting capacity, independence, communications, and operational framework of monetary policy.

b. **Reform the decision-making process in the NBU** so as to separate clearly the policy-setting function (which should be vested in the NBU Board and, eventually, in the Monetary Policy Committee (MPC)) from the function of conducting open market operations. Once the MPC is reactivated, we will vest in it the authority to set policy interest rates consistent with the inflation objectives.

c. **Provide the NBU full authority to develop and use its own projections** for inflation and other macroeconomic variables for the monetary policy purposes (decision-making will be firmly anchored in the NBU’s macroeconomic research). Importantly, the NBU will be free to set its own inflation target and will no longer be obliged to accommodate inflation projections developed by the Ministry of Economy and approved by the Government.

d. **Publish (with an appropriate lag) minutes of the NBU Board monetary policy meetings, and more generally strengthening the NBU’s communications strategy.**

e. **Refine the NBU’s monetary policy instruments** so as to align closely the interest rates on its active and passive operations of the NBU with the official policy rate. As the introduction of IT
approaches, the NBU will increasingly rely on adjusting its policy rate as needed to support domestic price stability, and anticipates maintaining positive real interest rates.

11. To help strengthen the independence, governance, transparency, and accountability of the NBU, and pave the way for adopting the inflation targeting regime, we will:

a. Establish an audit committee of the NBU Council (see paragraph 28).

b. Enact legal amendments abolishing the superiority of the Budget Law over the NBU Law, and discontinue advance profit transfers from the NBU to the budget during the fiscal year.

12. We will monitor our program through targets on net international reserves and monetary aggregates. We intend to meet NDA ceilings and NIR floors (quantitative performance criteria), with base money as an indicative target (see Table 3). The proposed NDA ceilings are consistent with our inflation objectives, while the NIR floors are designed to ensure an adequate level of international reserves.

B. Financial Sector Policies

13. We are committed to strengthening financial stability with a view to supporting economic growth. In recent years we have made progress in strengthening our financial sector. However, this sector has experienced some losses and liquidity pressures in recent months. We are taking steps to reduce vulnerabilities, protect depositors, and ensure financial stability by: (i) properly monitoring and supporting bank liquidity; (ii) assessing financial resilience in banks; (iii) restructuring and recapitalizing financial institutions in need; (iv) upgrading the regulatory and supervisory framework; and (v) enhancing banks’ capacity to resolve NPLs.

Monitoring and supporting bank liquidity levels

14. We will continue to provide adequate liquidity in the banking system in a transparent and expeditious manner. In February 2014 we eased reserve requirements and improved our liquidity facilities by accepting performing loans as collateral for our emergency liquidity support, after a prudent discount. We continue to monitor liquidity conditions on a daily basis. To facilitate the banks’ liquidity management and enhance our surveillance, we will ease reserve requirements further and allow banks to average their required reserves over the monthly maintenance period, as noted above in paragraph 9. We will also require, beginning end-March 2014, the largest 35 institutions to provide the NBU with their cash flow forecast for the following week. The NBU stands ready to take appropriate measures to maintain sufficient liquidity in all banks.
Assessing financial resilience

15. With the aim of enhancing market confidence and preserving financial stability, we will ensure that banks are well capitalized. To this end, we will:

a. Require independent diagnostic studies of current asset valuation and banks’ business plans through 2016 to verify the solvency and viability of our banks.

- On April 14, 2014, the NBU instructed the largest 35 banks to launch diagnostic studies on the basis of end-December 2013 data and terms of reference developed by the NBU (prior action). The diagnostic studies will assess the capital adequacy to meet a Tier 1 capital (“T1”) target of 7 percent within an overall capital requirement of 10 percent and 4.5 percent under the baseline and adverse macroeconomic scenarios agreed with the IMF, respectively. Additionally, banks will be required to submit to the NBU their business plans with the view to maintaining capital requirements through 2016. The terms of reference for the diagnostic studies, agreed with IMF and World Bank staff, will be prepared on the basis of the manual of the 2014 ECB Asset Quality Review and delivered to the auditors by end-April 2014. The terms of reference will, inter alia, specify that the selected auditor should not have conducted the regular annual audit of the specific bank during the past three years.

- For the 15 largest banks, these diagnostic studies and review of business plans will be completed by end-July 2014 (structural benchmark). Diagnostic studies of the 20 next largest banks and review of business plans will be completed by end-September 2014. Where an audit shows adequate capitalization and a business plan for a viable business and proper capitalization through 2016, no further steps will be required. However, banks with diagnostic studies revealing capital deficiencies or a non-self sustainable business through 2016 will be required to submit recapitalization and restructuring plans. These plans should address the findings of the diagnostic studies, including a clear commitment to fill capital shortfalls. Plans should be submitted for the NBU’s approval by end-September 2014 for the 15 largest banks and end-November 2014 for the 20 next largest banks.

- The NBU will appoint a Steering Committee to oversee the diagnostic process for each of the 35 banks to ensure consistency and that implementation meets the goals and modalities of the overall exercise. Staff of the IMF and the World Bank will be involved in the process.

- Assessment of the financial conditions of the remaining smaller institutions in the banking system will be completed by the second quarter of 2015 using banks’ annual audits and after factoring in any revisions to IFRS implementation that emanate from the assessment of IFRS implementation discussed below.

b. Take steps to ensure adequate capitalization of the financial sector. Banks must be compliant with the T1 capital targets of 7 percent under the baseline scenario and 4.5 percent under the adverse scenario through 2016. The deadlines for compliance are end-December 2014 for the 15 largest banks and end-February 2015 for the 20 next largest banks. Private owners of
banks will be asked to make up any shortfall under the base scenario against the 7 percent T1 and under the adverse scenario against the 4.5 percent T1 scenario through cash injection.

c. **Ensure proper backup recapitalization or restructuring funds are available should financing to cover capital shortfalls in systemically important banks not be forthcoming from the private sector.**

- If existing fit and proper shareholders are unwilling or incapable of recapitalizing in full a weak bank, public funds could be used to bring it back into solvency or orderly restructure it, according to strict criteria. Government and the NBU will reach agreement with IMF staff on these criteria by May 31, 2014 (**structural benchmark**). These criteria should include requirements to ensure that losses are passed to the shareholders before public funds are injected to recapitalize or restructure a bank and the appointment of a monitoring trustee to oversee the bank’s activities on behalf of the state. They will also include the requirement for a voluntary suspension of voting rights of shares held by any party that may be in process of filing documentation establishing ultimate ownership before the NBU. For these purposes, we will make the necessary legislative changes.

- The government will seek authorization in a supplementary budget as needed to provide sufficient financial support to banks, subject to strict procedures as agreed with the Fund staff, for the use of such support.

- We will set up a high level committee by end-March 2014 that will ensure proper governance in the use of public funds in bank recapitalizations and restructuring. This committee should be comprised of the Minister of Finance, the Governor of the NBU, and the head of the Deposit Guarantee Fund (DGF). This committee will immediately appoint a spokesperson to be in charge of the communication strategy of the recapitalization process with the aim of keeping markets and depositors effectively and timely informed.

- The government should be prepared to manage its financial sector shareholdings in the event that it is called on to use public funds—and to this end, a specialized unit will be set up at the Finance Ministry by end-September 2014 (**structural benchmark**). This unit will have a mandate to maximize the value of the State’s holdings and interact with the respective banks on an arm’s length basis. We will ensure that bank board members representing the State and bank managers are fit and proper and professionally suitable, and take responsibility for key decisions regarding the government as a shareholder. To ensure no political interference in the banks’ commercial business, a relationship framework between the Finance Ministry and each bank with State shareholding should be signed to govern the interaction between the two parties.

d. **Use the resolution mechanism in place when a bank is not supported by its shareholders or deemed unviable.** Resolution will take place through, in order of preference and according to feasibility, mergers, purchase and assumption (P&A), the use of bridge banks, full bank recapitalization by the State, or liquidation. The DGF should continue its role as the resolution agency to resolve banks, and steps will be taken to ensure it is adequately staffed and trained...
and has adequate reserves to fulfill its obligations in a timely manner (by end-July 2014). We will ensure that coordination between the NBU, the Finance Ministry, and the DGF is enhanced. To this end, we will revise the existing memorandum of understanding governing the relationship between these institutions (including on information sharing and cooperation) and publish, after consultation with IMF and World Bank staff, the revised version on their individual websites by end-May 2014.

e. **Address in a timely manner any bank that becomes problematic before the diagnostic studies process described above is complete.** We will monitor the banking system closely and send inspection teams to the field as needed. If a bank's capital declines below the regulatory minimum, the NBU will require that the shareholders submit an action plan to recapitalize the bank, as well as impose restrictions on the bank’s activities in line with the law. If the capital of the bank is below one-third of the minimum legally required level, the owners will be required to bring the bank immediately back into solvency in line with the existing legal framework. Otherwise, the institution will be put under temporary administration that removes bank managers and suspends the powers of general shareholders’ meeting, supervisory board, and board of directors. We commit to subject all banks under resolution to an official investigation by the DGF with the aim to identify whether wrong doing or bad banking practices led the bank into insolvency and to prosecute those found responsible.

**Upgrading the regulatory and supervisory framework**

16. **To boost confidence in the banking system, we will enhance our regulatory and supervisory framework.** To this end, we will:

a. **Ensure conservative implementation of IFRS accounting and disclosure practices on related parties, loan provisioning, collateral valuation and income recognition on NPLs.** In this regard, upon the completion of the diagnostic studies discussed above, we will, with technical assistance from the IMF, complete an assessment of whether accounting practices followed by a sample of large and medium-sized Ukrainian banks are comparable with those followed by international banks in other jurisdictions, by end-October 2014. If this assessment were to find material room to enhance IFRS implementation, including provisioning rules, assets and collateral valuation, then after consultation with IMF and World Bank staff, we will prepare guidelines to correct current practices in the banking system by end-November 2014 with the aim to be used in the preparation of the banks’ 2014 financial statements.

b. **Align existing foreign exchange rules to international best practices.** An important step in this regard will be to unwind Resolution 109. To this end, on April 4, 2014 the NBU repealed Resolution 109 and announced a specific timetable, agreed with IMF staff, for gradually unwinding banks’ net open foreign exchange positions, beginning May 1, 2014 and concluding in 20 months (prior action).

c. **Ensure actions to comply with Core Principles for Effective Bank Supervision (CPEBS),** particularly regarding the NBU’s supervisory model and consolidated supervision, as well as
crisis management. By end-December 2015, we will request from the IMF and World Bank a stand-alone assessment of our compliance with the CPEBS.

d. **Set up a central credit register at the NBU.** This register aims to monitor credit risk concentration and enhance the monitoring of large business groups (including those related to bank owners) and become an important tool of off-site and on-site banking supervision. To this end, the existing legal framework for the credit register will be revised by end-August 2014, in consultation with the IMF and WB staff, with the aim to become operational no later than August 2015.

**Facilitating banks’ capacity to resolve NPLs**

17. **We will take measures to facilitate effective private sector debt resolution.** We will work on two fronts:

a. **Assessing the banks’ policies and procedures for loan workouts.** As part of the diagnostic studies, we will ask the auditing firms to assess the quality of debt restructuring policies and procedures to ensure effective debt restructuring, including write-off and transfer of NPLs. The auditing firms’ reports will be completed by end-September 2014.

b. **Identifying legal impediments for effective out-of court debt resolution.** To this end, with technical assistance from the IMF by end-October 2014 we will review the current legal framework for NPLs resolution and identify existing legal, regulatory, and tax obstacles to effective debt restructuring.

C. **Fiscal Policy**

18. **The government’s immediate emphasis is maintaining timely priority spending.** Large macroeconomic and political uncertainties and disruptions have eroded revenues and led to a build-up of unpaid bills of (0.4 percent of GDP as of end-March). To address this challenge, the government approved a resolution on budget execution priorities in early March, and is further strengthening weekly cash management and expenditure prioritization tools. These tools include:

a. **Near-term revenue administration measures, including:** (i) breaking tax evasion schemes; (ii) halting imports through entries other than official checkpoints; (iii) strengthening control over sales of alcohol; (iv) enforcing collection of large debts; (v) tightening verification of compliance with recurrent tax obligations (VAT) through automation; (vi) conducting tax audits and expeditiously collecting the assessed amounts; and (vii) enhancing efforts to collect utility payments to improve the financial situation of Naftogaz.

b. **Expenditure prioritization** to meet debt service, wage, and pension obligations. Other spending pressure points will also be identified.

c. **Tapping financing** from the banking sector where possible.
The initial phase of fiscal adjustment will rely on a mix of revenue and expenditure measures (text table). We are targeting a structural fiscal adjustment of 1.0 of GDP this year. To this end, Government approved a package of revenue and expenditure measures yielding at least UAH 45 billion and implemented them by passing a supplementary budget on March 27, 2014 (prior action).

### Expenditure measures

<table>
<thead>
<tr>
<th>Description</th>
<th>Yield (UAH mln)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maintain the level of minimum wage and the first category tariff grade wage unchanged at their January 1, 2014 level during 12 months of 2014 and reduce employment by attrition.</td>
<td>7,300</td>
</tr>
<tr>
<td>Maintain the level of minimum subsistence level entering calculation of pensions and various pension-linked benefits at their January 1, 2014 level during 12 months of 2014 and suspend wage indexation of pensions.</td>
<td>2,900</td>
</tr>
<tr>
<td>Rationalization of expenditures in non-pension social funds and transfer of savings to the pension fund.</td>
<td>4,100</td>
</tr>
<tr>
<td>Rationalization of social assistance spending</td>
<td>2,300</td>
</tr>
<tr>
<td>Prioritization and rationalization of capital expenditures</td>
<td>7,700</td>
</tr>
<tr>
<td>Prioritization and rationalization of subsidies to enterprises</td>
<td>2,100</td>
</tr>
<tr>
<td>Enhancing efficiency of public procurement and reduction of other expenditures</td>
<td>3,200</td>
</tr>
<tr>
<td>Additional debt service costs associated with exchange rate depreciation and called guarantees</td>
<td>-3,700</td>
</tr>
<tr>
<td><strong>Total expenditure measures</strong></td>
<td><strong>25,900</strong></td>
</tr>
</tbody>
</table>

### Revenue measures

<table>
<thead>
<tr>
<th>Description</th>
<th>Yield (UAH mln)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Suspend application of zero VAT rate to export operations with grain and industrial crops during April 1–September 30, 2014.</td>
<td>4,000</td>
</tr>
<tr>
<td>Increase fees on the usage of mineral resources and broaden the base.</td>
<td>1,600</td>
</tr>
<tr>
<td>Increase in excise tax rates, and expansion of tax bases.</td>
<td>4,600</td>
</tr>
<tr>
<td>Introduce a reduced 7 percent VAT rate on pharmaceutical and medical products.</td>
<td>2,200</td>
</tr>
<tr>
<td>Improvement of tax administration through elimination of tax frauds discovered in fuel imports and production of alcoholic beverages.</td>
<td>6,700</td>
</tr>
<tr>
<td><strong>Total revenue measures</strong></td>
<td><strong>19,100</strong></td>
</tr>
</tbody>
</table>
**Expenditure measures**

a. We cancelled the increase in minimum wage previously planned for July and October 2014 and will keep the minimum wage at UAH 1,218 and the first category tariff grade wage at UAH 852 level until end-2014. This will restrain the increase of the wage bill in the public sector. We will discuss with Fund staff our wage policy for 2015 during program reviews.

b. We cancelled the increase in the minimum subsistence level entering calculations of pensions and pension-linked benefits previously planned for July and October 2014. Also, we suspended wage indexation of pensions previously planned for March 1, 2014.

c. We will maintain a hiring freeze for the general government, which will facilitate reduction in government employment headcount through the normal attrition and staff optimization. Exceptions from the hiring freeze to fill critical positions will amount to no more than 1/5 of the newly opening vacancies and need to be approved by the respective line ministries (which will monitor implementation as well).

d. In cooperation with the World Bank, we will re-prioritize social assistance benefits so as to move from a privilege-based system to a well-targeted means-tested framework.

e. On April 10, 2014 Parliament passed a new public procurement law to strengthen governance and checks and balances, including reducing exemptions from regular competitive procedures (prior action). This law will allow us to save substantial amounts on government purchases.

f. We will reduce: (i) administrative and non-priority expenditure of non-pension social funds; and (ii) subsidies to SOEs.

g. To limit fiscal risks and foster transparency, we will limit new loan guarantees issued by the central (state) government loan guarantees to no more than UAH 25 billion in 2014 (quantitative performance criterion). We will focus these guarantees on high priority projects, including where such guarantees are required to unlock complementary external financing.

**Revenue measures**

a. On March 27, 2014 Parliament passed a reversal of the already introduced VAT rate reduction in 2015, keeping the rate at 20 percent (prior action). We also introduced VAT taxation of pharmaceutical products at a rate of 7 percent.

b. After discussion within government and with the private sector, by end-September 2014 we will prepare a proposal for the reform of VAT in agriculture with a view to bringing the regime in this sector closer to the general VAT regime (structural benchmark). In this context, we will consider a reduction in VAT exemptions in agriculture in 2015.

c. As a stop-gap measure in the short run, on March 27 Parliament passed an extension in the recently expired VAT exemption regime for grain exporters until October 1, 2014 (prior action).

d. We revised relevant legislation to increase excise tax rate for alcohol and tobacco by 25 percent, for beer by 42.5 percent, and for diesel fuel (€98 and €128 per ton) instead of the current differentiation of rates subject to content of sulfur (€46, 68, 75 and 98 per ton), and conduct
price indexation of selected other products and series subject to excise taxation and duties, expressed as absolute values.

e. Our decisive efforts to improve revenue collection have already led to breaking two major fraudulent tax evasion schemes of the previous regime. This, together with the ongoing reorganization of state tax and customs services, will yield considerable additional revenues.

19. Over the medium-term, we will emphasize expenditure-led gradual fiscal consolidation to build confidence and reduce imbalances. High levels of public spending-to-GDP call for expenditure-led consolidation. Areas under consideration are steps to enhance public sector efficiency, including a broad review of public administration, and better utilization of the existing performance-based expenditure framework. An IMF mission is expected in late April to assess and provide options and priorities in this area, and we will embed key reforms from that discussion into our program at the time of the first review.

20. Consistent with the above strategy, we will target a cumulative structural fiscal adjustment of 2 percent of GDP through 2016. We will then target a gradually slowing pace of adjustment through 2019. This fiscal path takes into account the weaker economy this year while retaining some upfront consolidation to reduce large funding needs, build confidence, and support the external adjustment. This approach will place public debt firmly on a declining path.

a. This fiscal path implies the following overall fiscal balances. We will target combined deficits of the general government and Naftogaz consistent with 8.5 percent of GDP in 2014, 6.1 percent of GDP in 2015, and 4.4 percent of GDP in 2016. For the general government, we will target deficits consistent with 5.2 percent of GDP in 2014, 4.2 percent of GDP in 2015, and 3.1 percent of GDP in 2016. Intra-year targets consistent with these annual targets will be set as quantitative performance criteria (Table 3).

b. In order to address a build-up of VAT refund arrears that deprives companies of working capital, we will issue up to UAH 16.7 billion in government bonds this year. In this context: (i) we will make every effort to first identify ways to pay these refund arrears in cash; (ii) this will be a one-off operation; (iii) all arrears to be cleared with the bonds will first be properly verified; (iv) the bonds will be used only to pay VAT refund arrears accumulated through end-2013; and (v) the bonds will be fully marketable and issued at market interest rates. Finally, we will also undertake the reforms to the VAT refund process, as discussed in paragraph 26 below.

D. Energy Sector Policy

21. Two key operational elements of our energy sector strategy are: (i) strengthening finances in the sector by gradually narrowing the gap between tariffs and their cost-recovery levels; and (ii) providing better targeted subsidies to protect the poorest segment of society from higher tariffs. These efforts are expected to support other important goals of our energy strategy, namely to: reduce large quasi-fiscal losses and budget subsidies; rein in the current account deficit; provide resources and incentives to increase energy efficiency; promote domestic production and secure funds for domestic investment (and thereby boost growth and move towards energy
independence); and alleviate governance problems in the sector by reducing arbitrage opportunities for gas sales created by the existing tariff differentials across customer categories.

22. **Strengthening Naftogaz finances and reducing budget subsidies will require sustained increases in tariffs.** Naftogaz’s deficit is driven by the very low regulated prices on sales to households and district heating companies. Overall energy subsidies in Ukraine, on- and off-budget, are estimated to have been 7½ percent of GDP in 2012 with relatively well-off households capturing the larger share of the benefits. Naftogaz’s shortage of funds has also led to large arrears to Russia’s Gazprom, which exacerbate balance of payments problems, while vested interests continue to act as a drag on needed reforms.

a. **In 2014, the main objective will be to offset the negative impact of the exchange rate adjustment on Naftogaz balances and contain its deficit to 3.3 percent of GDP.** We will reduce Naftogaz’s deficit to 1.9 percent of GDP in 2015 and aim to eliminate it by 2018.

b. **However, Naftogaz’s financing gap this year is large,** at UAH 62 billion, of which the government has already provided UAH 11 billion. Filling the remaining gap of UAH 51 billion will require further support from the government. For this purpose, the government’s supplementary budget will include UAH 22 billion in ‘recapitalization’ bonds. To fill the remaining gap, Naftogaz will need to develop a plan, based on cost rationalization, improved revenue collection, and—taking into account the full effect of these measures—further financial backing from the budget, for repayment of its large arrears to Gazprom in a timely manner.

c. **To this end, we will ensure that:** (i) by April 10, 2014 the gas price regulator NERC will adopt and officially publish a decision to raise end-user gas tariffs for households by 56 percent, effective May 1, 2014; (ii) similarly, by April 18, 2014, the utility price regulator NURC will adopt decisions to raise the heating tariffs for households by 40 percent on average, effective July 1, 2014 (prior action). We will also complete the required legislative changes so that, going forward, all tariff increases will become effective within 40 days of their announcement. Full-cost retail gas and heating tariffs will be reflected on consumers’ utility bills to promote awareness of the importance of the reform for the medium term.

d. **We also passed and publicly announced on April 18, 2014 the decision and schedule for tariff increases through 2017,** where the schedule includes the following: (i) in 2015, we will raise end-user gas and heating tariffs by 40 percent on average, effective May 1; and (ii) thereafter we will raise these tariffs by 20 percent on average in each of 2016 and 2017, effective May 1, until losses of Naftogaz are eliminated by 2018 (prior action). To ensure depoliticization of tariff setting, Parliament passed legislation on April 10, 2014 to vest NURC with the exclusive authority to set heating tariffs in the country (prior action). NURC’s respective powers will not be infringed by adjacent reforms in the area of public administration.

e. **A well-coordinated campaign will be put in place** to inform the population why tariff hikes are necessary. The campaign will also lay out our approach to increased social assistance.
f. **By April 7, gas prices to industrial and budget consumers were adjusted in line with the actual gas imports costs**, taking into account new gas import prices and exchange rate movements.

g. **To provide an accurate picture of Naftogaz finances, we launched a tender on April 3 for an external auditor to conduct audits of Naftogaz operations.** The auditor will be in place within 60 days of the tender. The results of the audits will be shared with the IMF within 30 days of each period, initially on a monthly basis beginning with data for end-May 2014, and then on a quarterly basis for end-September data forward (structural benchmark). This will enhance Naftogaz’s transparency and support progress toward improved finances.

h. **To strengthen payment discipline for the heating sector,** Parliament will pass legislation that will make distribution accounts fully operational and mandatory for utility payments by end-June 2014 (structural benchmark). These accounts receive customer payments and then distribute them to Naftogaz and utility companies according to predetermined shares that ensure that Naftogaz recovers the cost of gas in the heating tariff. We will also: (i) raise building-level heating meter coverage from 36 to 45 percent by end-2014 together with heat controls at IHS; and (ii) move to respective consumption based utility bills rather than current use of norms. We expect that these measures will reduce incentives for district heating companies to overestimate residential heat consumption and overcharge residential consumers in order to reduce their financial losses.

i. **Deeper structural reforms are expected to diversify gas supply sources and reform Naftogaz,** in accordance with Ukraine’s membership in the Energy Community. We will work with the World Bank to consider options to identify strategic priorities, including restructuring.

j. **In close cooperation with the World Bank, we will continue our efforts to improve the energy efficiency** of Ukraine’s heating sector by addressing the efficiency of the residential sector (building efficiency, consumption-based billing), utilities (production efficiency, transmission of heat and distribution efficiency) and the public sector (public buildings).

23. **Protecting the most vulnerable from the impact of gas and heating tariff increases is a priority of our social policy.** To help offset the impact of the gas and heating tariff increases detailed above on the poorest segment of society, we will improve the targeting of our social assistance programs, consulting with IMF and World Bank experts. The existing Housing and Utility Subsidy program that covers the utility bills above 10/15 percent of the enrolled households’ income will fully shield them from the increase in gas and heating prices and will cover new entrants who have fallen on hard times. Moreover, to protect vulnerable households not covered by the existing scheme, Government approved on April 5, 2014 a decision to introduce a new social assistance scheme (**prior action**). By April 10, the government will share with IMF and World Bank staff a draft proposal specifying eligibility for the new scheme (with an envelope of UAH 3 billion), the amount of benefits, the mode of delivery, and the administrative process to obtain the assistance. The scheme will become effective July 1, 2014.
E. Governance, Transparency, and the Business Climate

24. **Strengthening governance and transparency of government operations and improving the business climate is a top priority of the new government.** While we are taking various steps in others areas to facilitate higher sustainable growth, we recognize that Ukraine’s business and investment environment remains a major drag on economic activity. Weak governance and transparency can be seen in a broad range of areas. These include weaknesses in the anti-corruption framework, the design and implementation of laws and regulations, the effectiveness of the judiciary, the anti-money laundering/combating of financing of terrorism (AML-CFT) framework, tax administration, procurement, and the energy sector. These weaknesses undermine public confidence in government, discourage foreign and domestic investment by raising the costs of doing business, and ultimately lead to reduction in public revenues. We believe that if we do not urgently address these challenges, we will not be able to meet our economic objectives.

25. **Many of these issues require deeper assessment and analysis to develop the most effective policy prescription.** Accordingly, we have requested a comprehensive diagnostic study to be completed in close consultation with IMF staff by July 15 that will cover the anti-corruption framework, the design and implementation of key laws and regulations that may have impact on business climate, the effectiveness of the judiciary, and tax administration (**structural benchmark**). Specifically, the diagnostic study will: (i) assess the current governance arrangements and frameworks in place, identifying areas for strengthening and reform; (ii) judge the relative importance of the issues flowing from the diagnostic findings; and (iii) propose specific remedial measures and time frames for their implementation. We welcome the assurance of IMF staff that other international organizations and bilateral partners active in these areas will be closely consulted as part of the study and that due regard will be paid to ensuring a collaborative and effective division of labor among our assisting partners. We commit to providing full support for the conduct of the study and to follow-up on its recommendations.

26. **There are also a number of issues that we can begin to address now.** We will:

a. **Establish by end-September 2014 specific criteria and rigorous procedures at the NBU needed to assess the fit and proper requirement in compliance with the AML/CFT standards,** including requirements to check the source of wealth/funds of owners of qualifying holdings of banks.

b. **Strengthen our AML framework. In this respect, relevant laws, will be revised in line with international standards by end-September 2014,** in consultation with IMF staff as needed, to ensure that: (i) banks are required to conduct enhanced due diligence on business relationships with domestic politically exposed persons; (ii) the laundering of the proceeds of tax crimes is criminalized; and (iii) financial secrecy laws do not inhibit AML implementation. Once the legal framework is in place, we will implement regulations and policies.

c. **Follow-up on our recent request for assistance from the World Bank, in the context of the Stolen Asset Recovery (“STAR”) Initiative.** We will work with the World Bank to develop a
strategy and action plan for pursuing and recovering stolen assets. In addition, we will reach out to international partners for their assistance, as appropriate.

d. Prepare, in consultation with the IMF and other international partners, a strategy by end-June 2014 for strengthening tax compliance of high income earners and those with foreign assets.

e. Address delays and weak transparency in granting VAT refunds. This has been a longstanding problem that has given rise to governance issues. We commit to the following measures in support of a more systematic, timely, and transparent approach for issuing VAT refunds: (i) implementation of an automatic VAT refund system to low-risk taxpayers without pre-payment inspection or audit of refund claims (by end-June 2014); (ii) resume publishing the amounts of VAT claims, outstanding refunds, settlements (including amounts released automatically), and arrears (by-end June); (iii) explore the possibilities of upgrading IT system to manage such refunds; (iv) revamp VAT refund criteria related to the taxpayer’s wage level to directly address the underreporting of wages; (v) ensure that all large taxpayers administered by the Large Taxpayer Inspectorates (LTIs) are by default included in the automated system (initially the current taxpayers administered by the LTI; (vi) consistent with the Tax Code, the practice of requesting CIT advance payments in exchange for VAT refunds will be prohibited—the State Tax Service will issue instructions to all tax offices to confirm this by end-June 2014.

27. We also recognize the need to take other actions to address the weak business climate and facilitate higher growth in Ukraine. The regulatory environment in Ukraine is overly complicated and imposes unnecessary costs for business. Measures will be developed in coordination with the World Bank and the EBRD, in the context of program reviews.

IV. Safeguards

28. We recognize the importance of completing an update safeguards assessment of the NBU by the first review of the Stand-By Arrangement. To facilitate this, we have authorized the NBU’s external auditors to provide all necessary information and hold discussions directly with IMF staff. The special audit of international reserves is currently being conducted by the NBU’s external audit firm to detail the composition and degree of encumbrance of gold and foreign exchange reserves. The report should be finalized by May 1. We also commit to receiving a safeguards mission and providing that mission with all requested information without delay, including information related to correspondent banks and foreign reserves placements. We will address outstanding issues from the 2011 safeguards assessment. In particular, we will take steps to strengthen the NBU’s governance, control and internal audit functions. On April 4 the NBU Council appointed an independent audit committee with two external members and with a well-defined mandate to provide close oversight of the financial reporting, audit processes and system of internal controls at the NBU (prior action). We will also undertake a review of the NBU’s legal framework to provide for the financial autonomy of the central bank and implement the independence requirements for NBU Council members by end-September 2014. Also, we will prepare a report by end-2014 on the status and steps taken to implement the recommendations of the external audit as to quality standards;
and select an external audit firm, by end-September 2014, to carry out the external audit of the NBU financial statement.

V. PROGRAM MONITORING

29. Program implementation will be monitored through prior actions, reviews (bi-monthly and then quarterly), quantitative performance criteria and indicative targets, and structural benchmarks. The phasing of purchases under the arrangement and the review schedule are set out in Table 2. The first bi-monthly review will be set for July 2014 based on end-May 2014 quantitative targets and taking into consideration structural benchmarks. For all reviews, quantitative targets will include: a ceiling on the cash deficit of the general government and on the combined deficits of the general government and Naftogaz; a ceiling on publicly guaranteed debt; a floor on cumulative change in the NIR; a ceiling on cumulative change in the NBU’s NDA; and non-accumulation of external debt payments arrears by the general government. The prior actions and structural benchmarks are set out in Table 1. The quantitative targets for target dates through end-December 2014, along with continuous quantitative performance criterion are set out in Table 3. The understandings between the Ukrainian authorities and IMF staff regarding the quantitative performance criteria and the structural measures described in this memorandum are further specified in the Technical Memorandum of Understanding (TMU) attached to this memorandum.
Table 1. Ukraine: Proposed Prior Actions and Structural Benchmarks 1/ (continues)

<table>
<thead>
<tr>
<th>Prior actions</th>
<th>Completion Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>The NBU will adopt a regulation specifying that the official exchange rate is calculated as a weighted average of rates on the same day’s interbank transactions.</td>
<td>March 31, 2014</td>
</tr>
<tr>
<td>The NBU will instruct the largest 35 banks to launch diagnostic studies on the basis of end-December 2013 data and terms of reference developed by the NBU.</td>
<td>April 14, 2014</td>
</tr>
<tr>
<td>The NBU will repeal Resolution 109 and announce a specific timetable, agreed with IMF staff, for gradually unwinding banks’ net open foreign exchange positions, beginning May 1, 2014 and concluding in 20 months.</td>
<td>April 4, 2014</td>
</tr>
<tr>
<td>Government will approve a package of revenue and expenditure measures yielding at least UAH 45 billion in and implement them by passing a supplementary budget.</td>
<td>March 27, 2014</td>
</tr>
<tr>
<td>Parliament will pass a new public procurement law to strengthen governance and checks and balances, including reducing exemptions from regular competitive procedures.</td>
<td></td>
</tr>
<tr>
<td>Parliament will pass a reversal of the already introduced VAT rate reduction in 2015 and keep the rate at 20 percent.</td>
<td>March 27, 2014</td>
</tr>
<tr>
<td>Parliament will pass an extension in the recently expired VAT exemption regime for grain exporters until October 1, 2014.</td>
<td>March 27, 2014</td>
</tr>
<tr>
<td>We will ensure that: (i) the gas price regulator NERC will adopt and officially publish a decision to raise end-user gas tariffs for households by 56 percent, effective May 1, 2014; (ii) similarly the utility price regulator NURC will adopt decisions to raise the heating tariffs for households by 40 percent on average, effective July 1, 2014.</td>
<td>April 18, 2014</td>
</tr>
<tr>
<td>We will also publicly announce the decision and schedule for tariff increases through 2017, where the schedule will include the following: (i) in 2015, we will raise end-user gas and heating tariffs by 40 percent on average, effective May 1; and (ii) thereafter we will raise these tariffs by 20 percent on average each year, effective May 1, until losses of Naftogaz are eliminated by 2018.</td>
<td></td>
</tr>
<tr>
<td>To ensure de-politicization of tariff setting, Parliament will pass legislation to vest NURC with the exclusive authority to set heating tariffs in the country.</td>
<td>April 10, 2014</td>
</tr>
<tr>
<td>To protect vulnerable households not covered by the existing scheme, Government will approve a decision to introduce a new social assistance scheme, as described in ¶23.</td>
<td>April 5, 2014</td>
</tr>
<tr>
<td>The NBU Council will establish an independent audit committee with a well-defined mandate to provide close oversight of the financial reporting, audit processes and system of internal controls at the NBU.</td>
<td>April 4, 2014</td>
</tr>
<tr>
<td>Structural benchmarks</td>
<td>Completion Date</td>
</tr>
<tr>
<td>--------------------------------------------------------------------------------------</td>
<td>--------------------------------------</td>
</tr>
<tr>
<td>Complete diagnostic studies and review of business plans for the 15 largest banks, as described in ¶15.</td>
<td>July 31, 2014</td>
</tr>
<tr>
<td>If existing fit and proper shareholders are unwilling or incapable of recapitalizing in full a weak bank, public funds could be used to bring it back into solvency, according to strict criteria. Government and the NBU will reach agreement with IMF staff on these criteria.</td>
<td>May 31, 2014</td>
</tr>
<tr>
<td>The government should be prepared to manage its financial sector shareholdings in the event that it is called on to use public funds—and to this end, a specialized unit will be set up at the Finance Ministry.</td>
<td>September 30, 2014</td>
</tr>
<tr>
<td>After discussion within government and with the private sector, we will prepare a proposal for the reform of VAT in agriculture with a view to bringing the regime in this sector closer to the general VAT regime.</td>
<td>September 30, 2014</td>
</tr>
<tr>
<td>To provide an accurate picture of Naftogaz finances, Naftogaz will launch a tender by April 3 to conduct audits of Naftogaz operations, led by an external auditor. The auditor will be in place within 60 days of the tender. The results of the audits will be shared with the IMF within 30 days of each period, initially on a monthly basis beginning with data for end-May 2014, and then on a quarterly basis for end-September data forward.</td>
<td>By June 30, 2014 and then monthly through October; then quarterly</td>
</tr>
<tr>
<td>To strengthen payment discipline for the heating sector, Parliament will pass legislation that will make distribution accounts fully operational and mandatory for utility payments.</td>
<td>June 30, 2014</td>
</tr>
<tr>
<td>Complete a comprehensive diagnostic study in close consultation with IMF staff that will cover the anti-corruption framework, the design and implementation of key laws and regulations that may have impact on business climate, the effectiveness of the judiciary, and tax administration, as described in ¶25.</td>
<td>By July 15, 2014</td>
</tr>
</tbody>
</table>

1/ Additional structural benchmarks will be proposed at the time of first program review.
### Table 2. Ukraine: Access and Phasing Under the Stand-By Arrangement

<table>
<thead>
<tr>
<th>Date</th>
<th>Amount of purchase</th>
<th>Conditions</th>
</tr>
</thead>
<tbody>
<tr>
<td>April 30, 2014 1/</td>
<td>2,058.00</td>
<td>150.00 Board approval of arrangement</td>
</tr>
<tr>
<td>July 25, 2014</td>
<td>914.67</td>
<td>66.67 First review and end-May 2014 performance criteria</td>
</tr>
<tr>
<td>September 25, 2014</td>
<td>914.67</td>
<td>66.67 Second review and end-July 2014 performance criteria</td>
</tr>
<tr>
<td>December 15, 2014</td>
<td>914.66</td>
<td>66.67 Third review and end-September 2014 performance criteria</td>
</tr>
<tr>
<td>March 15, 2015</td>
<td>1,372.00</td>
<td>100.00 Fourth review and end-December 2014 performance criteria</td>
</tr>
<tr>
<td>June 15, 2015</td>
<td>1,372.00</td>
<td>100.00 Fifth review and end-March 2015 performance criteria</td>
</tr>
<tr>
<td>September 15, 2015</td>
<td>1,372.00</td>
<td>100.00 Sixth review and end-June 2015 performance criteria</td>
</tr>
<tr>
<td>December 15, 2015</td>
<td>1,372.00</td>
<td>100.00 Seventh review and end-September 2015 performance criteria</td>
</tr>
<tr>
<td>March 15, 2016</td>
<td>686.00</td>
<td>50.00 Eighth review and end-December 2015 performance criteria</td>
</tr>
<tr>
<td>Total</td>
<td>10,976</td>
<td>800.0</td>
</tr>
</tbody>
</table>

Source: IMF staff estimates.

1/ Of which SDR1,290 (about US$2 billion) for budget support.
Table 3. Ukraine: Quantitative Program Targets 1/
(End of period; millions of Ukrainian hryvnias, unless otherwise indicated)

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>March</td>
</tr>
<tr>
<td>I. Quantitative performance criteria</td>
<td></td>
</tr>
<tr>
<td>Ceiling on the cash deficit of the general government (- implies a surplus) 2/</td>
<td>18,000</td>
</tr>
<tr>
<td>Ceiling on the cash deficit of the general government and Naftogaz (- implies a surplus) 2/</td>
<td>28,200</td>
</tr>
<tr>
<td>Floor on cumulative change in net international reserves (in millions of U.S. dollars) 3/ 4/</td>
<td>11,100</td>
</tr>
<tr>
<td>Ceiling on cumulative change in net domestic assets of the NBU 3/ 4/</td>
<td>207,465</td>
</tr>
<tr>
<td>Ceiling on publicly guaranteed debt 2/</td>
<td>0</td>
</tr>
<tr>
<td>II. Continuous performance criterion</td>
<td></td>
</tr>
<tr>
<td>Non-accumulation of new external debt payments arrears by the general government 2/</td>
<td>0</td>
</tr>
<tr>
<td>III. Indicative Targets</td>
<td></td>
</tr>
<tr>
<td>Ceiling on cumulative change in base money 3/</td>
<td>329,061</td>
</tr>
<tr>
<td>Ceiling on net accumulation of VAT refund arrears 5/</td>
<td>21,700</td>
</tr>
<tr>
<td>IV. Memorandum Items</td>
<td></td>
</tr>
<tr>
<td>External project financing 2/</td>
<td>317</td>
</tr>
<tr>
<td>NBU loans to DGF and purchases of Government bonds issued for DGF financing or banks recapitalization 3/</td>
<td>0</td>
</tr>
<tr>
<td>Government bonds issued for banks recapitalization 3/</td>
<td>0</td>
</tr>
<tr>
<td>Stock of budgetary arrears on social payments 2/</td>
<td>0</td>
</tr>
<tr>
<td>Programmed disbursements of international assistance except IMF (millions of U.S. dollars) 3/ 4/</td>
<td>29</td>
</tr>
<tr>
<td>Percent of it applied to adjustment</td>
<td>...</td>
</tr>
<tr>
<td>Naftogaz foreign exchange purchases from NBU for the purposes of repaying gas payment arrears to Gazprom and Eurobond issue maturing in September 2014 (millions of U.S. dollars) 3/</td>
<td>813</td>
</tr>
<tr>
<td>NBU purchases of T-bonds issued by Government for Naftogaz recapitalization 3/ 4/</td>
<td>11,100</td>
</tr>
<tr>
<td>Financing by multilateral institutions and official bilateral creditors disbursed to Naftogaz for investment projects 2/</td>
<td>0</td>
</tr>
<tr>
<td>Net transfers made by Gazprom (advance transit fee) 2/</td>
<td>0</td>
</tr>
<tr>
<td>Arrears to Gazprom for gas imports (millions of U.S. dollars) 6/</td>
<td>2,160</td>
</tr>
<tr>
<td>Ceiling on bonds issued to pay VAT refund arrears (VAT bonds) 2/</td>
<td>0</td>
</tr>
<tr>
<td>Program exchange rate, Hryvnia per U.S. dollar</td>
<td>10.9546</td>
</tr>
</tbody>
</table>

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 are cumulative flows from end-2013. Data for March are flows from end-December, 2013.
3/ Targets and projections are cumulative flows from April 1, 2014. Data for March are stocks as of end-March, 2014.
4/ Calculated using program exchange rates specified in the TMU.
5/ Targets and projections are cumulative flows from January 1, 2014. Data for March are stocks as of end-March, 2014. MoF will issue UAH 16.7 bhn in VAT bonds to settle VAT refund arrears accumulated through December 31, 2013.
6/ Targets and projections are cumulative flows from the Board approval of the Program. Data for March are stocks as of end-March, 2014.
Attachment II. Technical Memorandum of Understanding

April 22, 2014

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 quantitative targets (performance criteria and indicative targets) for the economic program supported under the Stand-By Arrangement, as described in the authorities’ Letter of Intent (LOI) dated April 22, 2014 and the attached Memorandum of Economic and Financial Policies (MEFP). It also describes the methods to be used in assessing the program performance and the information requirements to ensure adequate monitoring of the targets. As is standard under all Fund arrangements, we will consult with the Fund before modifying measures contained in the LOI, or adopting new measures that would deviate from the goals of the program, and provide the Fund with the necessary information for program monitoring.

2. The quantitative performance criteria are shown in Table 3 of the MEFP. The definitions of these quantitative targets and the adjustment mechanisms are described in Section I below. Prior actions and structural benchmarks are listed in Table 1 of the MEFP, with corresponding definitions 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 10.9546 set by the NBU as of March 31, 2014, and (ii) reference exchange rates of foreign currencies reported by the European Central Bank (ECB) on its web site as of March 28, 2014, which the NBU used to set official exchange rates of hryvnia to those currencies. In particular, the Swiss Franc is valued at 0.8857 per dollar, the Euro is valued at 1.3759 dollars, Pound Sterling is valued at 1.6633 dollars, Australian dollar is valued at 0.9243 U.S. dollars, and the Japanese yen is valued at 102.41 per dollar. The accounting exchange rate for the SDR will be 0.647773 per dollar. Official gold holdings were valued at 1,295.75 dollars per fine ounce. These program exchange rates are kept fixed over the program period. Therefore, the program exchange rate differs from the actual exchange rate set in the foreign exchange market. 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. For the purpose of the program, gross domestic product is compiled as per the System of National Accounts 1993 (SNA’93). The State Statistics Service has indicated that they plan to change to the System of National Accounts 2008 and discontinue the series based on SNA’93 at some point in 2014. We will reach agreement with the Fund before making any modifications in GDP compilation used for purposes of the program.
I. QUANTITATIVE PERFORMANCE CRITERIA, INDICATIVE CEILINGS, AND CONTINUOUS PERFORMANCE CRITERIA

A. Floor on Cumulative Change in Net International Reserves
   (Performance Criterion)

Definition

5. 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.

6. Usable gross international reserves comprise all readily available claims on nonresidents denominated in convertible foreign currencies, consistent with the Balance of Payments Manual (Fifth Edition) and the Special Data Dissemination Standard (SDDS) (Table A, item 1). 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 of lack of quality or lack of liquidity that limits marketability at the book price.

7. For the purpose of this program, reserve-related liabilities comprise:

- all short-term liabilities of the NBU vis-à-vis nonresidents with an original 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 against domestic currency; 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) excluding foreign exchange liabilities to the general government, or related to deposit guarantees.

| Table A. Components of Net International Reserves |

<table>
<thead>
<tr>
<th>Type of Foreign Reserve Asset or Liability(^2)</th>
<th>NBU Balance Sheet and memorandum Accounts</th>
</tr>
</thead>
</table>

1. **International reserves**

   - Monetary gold
   - Foreign exchange in cash
   - Demand deposits at foreign banks
   - Short-term time deposits at foreign banks
   - Long-term deposits at foreign banks
   - SDR holdings and Reserve Position in the IMF
   - Securities issued by nonresidents

<table>
<thead>
<tr>
<th>NBU Balance Sheet and memorandum Accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>1100, 1107</td>
</tr>
<tr>
<td>1011, 1017</td>
</tr>
<tr>
<td>1201, 1202</td>
</tr>
<tr>
<td>1211, 1208</td>
</tr>
<tr>
<td>1212</td>
</tr>
<tr>
<td>IMF, Finance Department(^3)</td>
</tr>
<tr>
<td>1300, 1305, 1307, 1308, minus 1306</td>
</tr>
</tbody>
</table>

2. **Short-term liabilities to nonresidents (in convertible currencies)**

   - Correspondent accounts of nonresident banks
   - Funds under required reserves transferred by the banks
   - Short-term deposits of nonresident banks
   - Operations with nonresident customers
   - Use of IMF credit

<table>
<thead>
<tr>
<th>NBU Balance Sheet and memorandum Accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>3201</td>
</tr>
<tr>
<td>3203</td>
</tr>
<tr>
<td>3211</td>
</tr>
<tr>
<td>3230, 3232, 3233</td>
</tr>
<tr>
<td>IMF, Finance Department</td>
</tr>
</tbody>
</table>

\(^1\) This refers to the notional value of the commitments, not the market value.

\(^2\) 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 March 31, 2014. 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.

\(^3\) 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.
Adjustment mechanism

- For end-May and end-July 2014 test dates, the NIR targets will be adjusted upward (downward) by the full amount of the cumulative excess (shortfall) in program disbursements relative to the baseline projection (Table B). For end-September and end-December 2014 test dates, the NIR targets will be adjusted upward (downward) by the full amount (75 percent) of the cumulative excess (shortfall) in program disbursements relative to the baseline projection (Table B). Program disbursements are defined as external disbursements from official multilateral creditors (World Bank, European Commission, European Investment Bank, and European Bank for Reconstruction and Development), official bilateral creditors (net), and external bond placements that are usable for the financing of the central government budget.

- NIR targets will be adjusted upward by the full amount of the cumulative shortfall in Naftogaz purchases of foreign exchange from NBU for the purposes of repaying gas supply arrears to Gazprom and Eurobond issue maturing in September 2014 relative to the baseline projection (Table C).

Table B. Eurobond Placements and Disbursements from IFIs and Official Sources: Projections for NIR/NDA Adjustment

(Cumulative flows from end-March 2014, millions of US dollars at program exchange rate)

<table>
<thead>
<tr>
<th></th>
<th>Eurobond placement</th>
<th>World Bank</th>
<th>EU</th>
<th>EBRD</th>
<th>EIB</th>
<th>Others (Canada, Japan)</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>End- May 2014</td>
<td>0</td>
<td>175</td>
<td>160</td>
<td>273</td>
<td>341</td>
<td>200</td>
<td>1,150</td>
</tr>
<tr>
<td>End-July 2014</td>
<td>1,000</td>
<td>1,350</td>
<td>867</td>
<td>546</td>
<td>683</td>
<td>300</td>
<td>4,746</td>
</tr>
<tr>
<td>End-September 2014</td>
<td>1,000</td>
<td>1,350</td>
<td>1,907</td>
<td>546</td>
<td>683</td>
<td>300</td>
<td>5,786</td>
</tr>
<tr>
<td>End-December 2014</td>
<td>1,000</td>
<td>1,850</td>
<td>1,907</td>
<td>546</td>
<td>683</td>
<td>300</td>
<td>6,286</td>
</tr>
</tbody>
</table>
Table C. Naftogaz Purchases of Foreign Exchange from NBU: Projections for NIR/NDA Adjustment

- (Cumulative flows from end-March 2014)

<table>
<thead>
<tr>
<th></th>
<th>Naftogaz purchases of foreign exchange from NBU for the purposes of repaying gas supply arrears to Gazprom and Eurobond issue maturing in September 2014 (millions of U.S. dollars)</th>
<th>NBU purchases of T-bonds issued by Government for Naftogaz recapitalization (millions of hryvnia, at program exchange rates)</th>
</tr>
</thead>
<tbody>
<tr>
<td>End-May 2014</td>
<td>2,160</td>
<td>23,662</td>
</tr>
<tr>
<td>End-July 2014</td>
<td>2,160</td>
<td>23,662</td>
</tr>
<tr>
<td>End-September 2014</td>
<td>3,830</td>
<td>41,956</td>
</tr>
<tr>
<td>End-December 2014</td>
<td>4,830</td>
<td>52,911</td>
</tr>
</tbody>
</table>

B. Ceiling on Cumulative Change in Net Domestic Assets of the NBU (Performance Criterion)

Definition

8. Net domestic assets (NDA) of the NBU are defined as the difference between the monetary base (as defined below) and the NIR of Ukraine (as defined above). For the purpose of computing the NDA target, the NIR is valued at the program exchange rate of UAH 10.9546 per dollar and expressed in hryvnia.

Adjustment mechanism

- Consistent with the NIR target adjustment mechanism (as defined above), NDA targets for the end-May and end-July 2014 test dates will be adjusted downward (upward) by the full amount of the cumulative excess (shortfall) in program disbursements relative to the baseline projection (Table B) and evaluated at the program exchange rate. NDA targets for end-September and end-December 2014 test dates will be adjusted downward (upward) by the full amount (75 percent) of the cumulative excess (shortfall) in program disbursements relative to the baseline projection (Table B) and evaluated at the program exchange rate.

- Consistent with the NIR target adjustment mechanism (as defined above), NDA targets will be adjusted downward by the full amount of the cumulative shortfall in NBU purchases of T-bonds issued by Government for Naftogaz recapitalization for the purposes of repaying gas supply...
arrears to Gazprom and Eurobond issue maturing in September 2014 relative to the baseline projection, evaluated at the program exchange rate (Table C).

- NDA targets will be adjusted upward by the full amount of the cumulative excess in the total amount of NBU loans to the Deposit Guarantee Fund (DGF) as well as total amount of NBU purchases of government bonds issued for the purposes of DGF financing, and NBU purchases of government bonds issued (up to a limit of UAH 15 billion) for bank recapitalization, relative to the baseline projection (Table D).

Table D. NBU Loans to DGF and Purchases of Government Bonds Issued for DGF Financing or Banks Recapitalization: Projections for NDA/Monetary Base Adjustment

<table>
<thead>
<tr>
<th></th>
<th>NBU purchase of Government bonds issued for DGF financing</th>
<th>NBU purchase of Government bonds issued for banks recapitalization</th>
<th>NBU loans to DGF</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>End-May 2014</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>End-July 2014</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>End-September 2014</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>End-December 2014</td>
<td>0.0</td>
<td>15,000</td>
<td>0.0</td>
<td>15,000</td>
</tr>
</tbody>
</table>

C. Ceiling on Cumulative Change in Monetary Base of the NBU (Base Money) (Indicative Target)

Definition

9. The NBU’s monetary base comprises domestic currency outside banks and banks’ reserves, including cash in vault of commercial banks, and funds of customers at the NBU. Currency outside banks is defined as: Currency—banknotes and coins—(NBU accounts 3000 (net)+3001 (net)-3007A-3009A-1001A-1004A-1007A-1008A-1009A) minus cash in vault at deposit money banks (DMBs) (DMB accounts 1001A:1005A, and 1007A). Banks’ reserves are defined as: cash in vault at deposit

1 The definitions set out here will be modified to include any other accounts that may be identified or created in the future in connection with domestic currency issue and the deposit money banks’ deposits at the NBU.
money banks (DMB accounts 1001A:1005A, and 1007A) plus DMB correspondent account deposits at the NBU in hryvnia (NBU liabilities accounts 3200, 3203, 3204, and 3206) plus funds of customers at the NBU in hryvnia (NBU liabilities accounts of groups 3233, 3250, 4731, 4732, 4735, 4736, 4738, 4739, and 4750), plus accrued interest on time deposits of DMBs in national currency (NBU accounts 3208L), plus accrued interest on client’s current accounts in national currency.

Adjustment mechanism

- Consistent with the NDA target adjustment mechanism (as defined above), monetary base targets will be adjusted upward by the full amount of the cumulative excess in the total amount of NBU loans to the Deposit Guarantee Fund (DGF) as well as total amount of NBU purchases of government bonds issued for the purposes of DGF financing or banks recapitalization (up to a limit of UAH 15 billion for purposes of recapitalization), relative to the baseline projection (Table D), and evaluated at the program exchange rate if provided in foreign exchange.

D. Ceiling on Cash Deficit of the General Government
(Performance Criterion)

Definition

10. The general government comprises the central (state) government, including the Road Fund (UkrAvtoDor), all local governments, and all extra budgetary funds, including the Pension, Unemployment Insurance, Temporary Disability Insurance, Occupational Injury and Disease Insurance Funds. 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. The cash deficit of the general government is measured by means of net financing flows as:

- total net treasury bill sales\(^3\) (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 SOEs, less the cumulative total

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\(^{2}\) Includes accounts of following sectors: 2 – other financial intermediaries and other financial organizations; 6 – regional and local authorities; 7 – government non-financial corporations; 8 – private and foreign-controlled non-financial corporations; 9 – non-commercial organizations serving households.

\(^{3}\) From here on, treasury bills are defined as all treasury securities (including long term instruments or treasury bonds).
redemption of principal on treasury bills), excluding bonds issued to recapitalize Naftogaz and other SOEs and banks; plus

- other net domestic banking system credit to general government 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 received by the State Property Fund and local governments (including the change in the stock of refundable participation deposits); plus

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

- the difference between disbursements of foreign credits to the general government (including project loans on-lent to public enterprises) and the amortization of foreign credits by the general government (including on-lent project loans); 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.

11. For the purposes of measuring the deficit 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 in hryvnias at the official exchange rate established as of the date of the transaction.

Adjustment mechanism

- The ceiling on the cash deficit of the general government is subject to an automatic adjuster based on deviations of external project financing (defined as disbursements from bilateral and multilateral creditors to the consolidated general government for specific project expenditure) from program projections (Table E). Specifically, if the cumulative proceeds from external project financing (in hryvnia evaluated at actual exchange rates):

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4 These are included in the calculation of Naftogaz’ cash deficit when they are used (as collateral for a loan, or as an outright sale) by the latter to obtain financing.
a) exceed program projections, the ceiling on the consolidated general government deficit will be adjusted upward by 100 percent of the excess in external project financing; and

b) fall short of program projections, the ceiling on the consolidated general government deficit will be adjusted downward by 100 percent of the shortfall in external project financing.

Table E. External Financing of General Government Projects—Adjustment

<table>
<thead>
<tr>
<th>Cumulative flows from January 1, 2014</th>
<th>In millions of hryvnia</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>External project financing</strong> (technical assumption for the adjuster purpose)</td>
<td></td>
</tr>
<tr>
<td>End-May 2014</td>
<td>2,800</td>
</tr>
<tr>
<td>End-July 2014</td>
<td>5,000</td>
</tr>
<tr>
<td>End-September 2014</td>
<td>15,500</td>
</tr>
<tr>
<td>End-December 2014</td>
<td>31,400</td>
</tr>
</tbody>
</table>

- The ceilings on the cash deficit of the general government at end-May, end-July, end-September, and end-December 2014 are subject to an automatic adjuster corresponding to the full amount of NBU purchases of government bonds issued for the purposes of DGF financing (excluding subsequent interest payments on the securities or other instruments issued). These ceilings are also subject to an automatic adjuster corresponding to the amount of NBU purchases of government bonds issued for the purposes of banks recapitalization, up to a cumulative maximum of UAH 15 billion in 2014. The test date ceilings on the cash deficit of the general government for 2015 will be adjusted upward by any amount of the UAH 15 billion bank recapitalization ceiling under the program that is not used in 2014.

- The ceiling on the cash deficit of the general government is subject to an automatic adjuster on the stock of budgetary arrears on social payments. Budgetary arrears on social payments comprise all arrears of the consolidated budget on wages, pensions, and social benefits owed by the Pension Fund, and the central or local governments. Budgetary arrears are defined as payments not made thirty days after they are due. Wages are defined to comprise all forms of remuneration for work performed for standard and overtime work. Pension obligations of the Pension Fund comprise all pension benefits and other obligations of the Pension Fund.

- The ceilings on the cash deficit of the general government at end-May, end-July, end-September, and end-December 2014 are subject to an automatic upward adjustment for the full amount of bonds used to pay VAT refund arrears (VAT bonds) accumulated before January 1, 2014, and will be limited to no more than UAH 16.7 billion cumulatively during 2014. No such bonds will be issued in 2015 or later, and therefore there is no such adjustment for the other test dates. The ceiling on the cash deficit of the general government at all other 2014 test
dates will be automatically adjusted downward by VAT refund arrears accumulated in excess of ceilings defined in Section E from January 1, 2014.

E. Ceiling on VAT Refund Arrears
(Indicative Target)

12. The ceiling on net accumulation of VAT refund arrears is set to UAH 5 billion at end-May 2014, UAH 5 billion at end-July 2014, UAH 2.5 billion at end-September 2014, and UAH 0 billion at end-December 2014. The stock of VAT refund arrears is defined as those claims that have not been settled (through a cash refund, netting out against obligations of taxpayers, payment with a government bond (VAT bond) or an official decision to reject the claim) within a specified time period after the VAT refund claim has been submitted to the State Tax Service (STS). In 2014, this time period is 74 days, allowing for verification of the validity and payment processing of claims. According to this definition, the stock of VAT refund arrears as of December 31, 2013 was UAH 16.7 billion and UAH 21.7 billion as of March 31, 2014.

F. Ceiling on Cash Deficit of the General Government and Naftogaz
(Performance Criterion)

Definition

13. The cash deficit of the General Government and Naftogaz is the cash deficit of the General Government as defined above plus the cash deficit of Naftogaz

14. Naftogaz is defined as the national joint stock company “Naftogaz of Ukraine.” The cash deficit of Naftogaz is measured from below the line as:

- net domestic banking system credit to the company (this consists of all financing in either domestic or foreign currency extended to the company by banks less the change in company deposits in the banking system); plus

- the difference between disbursements of official foreign credits to Naftogaz (including project loans) and the amortization of official foreign credits (including project loans); plus

- the disbursements of trade credits from Gazprom to import gas; plus

- the difference between disbursements and amortization on any bonds issued by Naftogaz; plus

- the net change in deposits of Naftogaz in nonresident banks, or other nonresident institutions; plus

- net proceeds from any promissory note or other financial instruments issued by Naftogaz; plus
• net receipts from sale of financial assets (including recapitalization or other form of treasury securities issued to Naftogaz, irrespective of their issuance date); plus

• any other forms of financing of the company not identified above.

15. For the purposes of measuring the deficit of Naftogaz, all flows in foreign currency will be accounted in hryvnias at the official exchange rate established as of the date of the transaction.

Adjustment mechanism

➢ The ceiling on the cash deficit of the general government and Naftogaz will be adjusted upward by the amount of financing by multilateral institutions and official bilateral creditors disbursed to Naftogaz for investment projects.

➢ The ceiling on the cash deficit of the general government and Naftogaz will be adjusted downward by the net transfers made by Gazprom (advance transit fee). These transfers are measured on a cumulative basis from the beginning of each calendar year.

➢ The ceiling on the cash deficit of the general government and Naftogaz will be adjusted downward by the amount of arrears to Gazprom for gas imports the day after their payment is due (7th day of the subsequent month of imports).

G. Ceiling on Non-Accumulation of New External Debt Payments Arrears by the General Government

(Continuous Performance Criterion)

Definition

16. For the purposes of the program, an external debt payment arrear will be defined as a payment by the general government, which has not been made within seven days after falling due (including grace period, if any). The performance criterion will apply on a continuous basis throughout the program period.

H. Ceiling on Publicly Guaranteed Debt

(Performance Criterion)

Definition

17. The ceiling on publicly guaranteed debt will apply to the amount of guarantees issued in 2014 by the central (state) government. The official exchange rate will apply to all non-UAH denominated debt. New state guarantees in 2014 will amount to no more than UAH 25 billion.
I. Other Continuous Performance Criteria

18. During the period of the Stand-By Arrangement, Ukraine will not (i) impose or intensify restrictions on the making of payments and transfers for current international transactions; (ii) introduce or modify multiple currency practices; (iii) conclude bilateral payments agreements that are inconsistent with Article VIII; and (iv) impose or intensify import restrictions for balance of payments reasons.

II. Official Exchange Rate

Determination of the official exchange rate

19. The NBU will, on a daily basis, set the official rate calculated as a weighted average of rates on the same day’s interbank market transactions. NBU will make public its official exchange rate by no later than 16:00 of the day for which it is set.

III. Reporting Requirements

A. National Bank of Ukraine

20. The NBU will continue to provide to the IMF on a monthly basis, no later than the 25th day of the following month, an aggregate balance sheet for the NBU and a consolidated balance sheet for the deposit money banks.

21. The NBU will provide to the IMF, on a weekly basis, with daily data the stock of net and gross international reserves, at both actual and program exchange rates. In addition, it will provide on a weekly and monthly basis, no later than the 25th of the following month, the full breakdown of NBU accounts included in net international reserves (defined in Table A above).

22. The NBU will provide the IMF on a daily basis with information on official foreign exchange interventions. In this context, it will also provide the results of any foreign exchange auctions.

23. The NBU will provide the IMF on a daily basis with information 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”, created according to the NBU Resolution 49.

24. The NBU will continue to provide on its web site the daily holdings of treasury bills at primary market prices, at current exchange rates. The NBU will also provide information on daily holdings of treasury bills broken down by type of holders (including state-owned banks and private banks) at primary market prices at the rate fixed on the day of auction information on t-bills sales, including in the foreign exchange, from the beginning of the year at the official rate as of the date of placement, as well as the t-bills in circulation, by principal debt outstanding at the official rate.
exchange rate as of the date of placement (OP-2); reports on each treasury bill auction; and provide to the IMF the monthly report on treasury bills, in the format agreed with the IMF staff.

25. The NBU will provide information on daily transactions (volumes and yields) on the secondary market treasury bills (including over the counter transactions).

26. The NBU will provide to the IMF, on a daily basis, the information on the banks’ claims on the loans provided and liabilities in the format agreed with the IMF staff.

27. The NBU will keep providing to the IMF, on a monthly basis, general information on the NBU financing (as well as the 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 format agreed with the IMF staff.

28. The NBU will provide to the IMF, on a quarterly basis but not later than 30 days after the expiration of the reporting quarter, the report on the banking sector financial stability indicators in the format agreed with the IMF staff.

29. Every 10 days, the NBU will continue to provide the IMF with the operational monetary survey of the NBU, including any additional information that is needed for the IMF staff to monitor monetary policy and developments in the banking sector.

30. The NBU will provide to the IMF, on a monthly basis, the net domestic assets data based on the monthly balance sheets within three weeks following the end of the month.

31. The NBU will continue to provide to the IMF the daily operational balance sheets of the NBU and commercial banks on a daily basis according to standard reporting forms, including 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, 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 State Treasury denominated in foreign currency (account 3513 A).

32. The NBU will provide to the IMF, on a monthly basis, projections for external payments falling due in the next twelve 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 (including arrears) for both public and private sectors.

34. 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 currency breakdown of
interbank market operations. The NBU will continue to provide daily information on exchange market transactions including the exchange rate.

35. The NBU will provide to the IMF reports N 381.25; 381.26 with information on reserve requirements.

36. The NBU will provide the IMF, on a two weekly basis, with daily data on the total financing (including refinancing) issued by the NBU to commercial banks, broken down by types of instrument, original maturity of the financing, interest rate as well as transactions to absorb liquidity from the banking system.

37. The NBU will provide the IMF on a two weekly basis, in an agreed format, data for the entire banking sector as well as on a bank-by-bank basis for Group I and Group II banks on total assets and liabilities; weighted averages based on banks' total assets; capital adequacy ratios for normative and regulatory capital (Tier I and Tier II); deposits (maturity, currency, and type of depositor); loans (local currency, foreign exchange, provided to the public and private sector, classified as standard, watch, substandard, doubtful); provisions for all loans (classified by types of loans); foreign exchange net open position; banks holding of government and private debt instrument; mandatory reserve requirement and access holding at the NBU.

38. The NBU will inform the IMF within the same day of any regulatory and supervisory measures against banks violating the NBU regulations, including lower capital adequacy, liquidity ration, large exposures, connected lending.

39. The NBU will continue to provide on a monthly basis, no later than 25 days after the end of the month, banking system monitoring indicators in an agreed format. This includes inter alia data on nonperforming loans (substandard, doubtful, and loss criterion).

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

41. The NBU will provide data on credit to nongovernment units that are guaranteed by the NBU on a monthly basis no later than 25 days after the end of the month.

42. The NBU will inform IMF staff if the Treasury does not pay interest or principal on treasury bills 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.

43. The NBU will inform IMF staff of any changes to reserve requirements for deposit money banks.

44. 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.
45. 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.

46. The NBU will continue to provide the Fund 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.

B. Ministry of Finance

47. 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.

48. 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), weekly balances of Treasury cash flow (outturn and forecast), including data on government foreign exchange deposits, in a format agreed with IMF staff, 10-day basis data on revenue of the state, local government, and consolidated budgets, monthly data on funds, deposited with the Single Treasury Account, on the registration accounts of the entities which are not included to the state sector, information on the stock of public entities in account #3712 within the Single Treasury Account, on inflow to the State budget from placing Treasury or any other liabilities to households in foreign and domestic currency and their redemption.

49. The Treasury will continue to provide to the IMF in electronic form monthly and quarterly treasury reports, no later than 25 and 35 days after the end of the period respectively. The Treasury 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.

50. The Ministry of Finance will report monthly data on the public wage bill in line with the template agreed with the IMF staff. It will also 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, no later than 15 days after the end of the month, the cash deficit 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 for 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. 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.

51. 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 deficit 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 for 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.

52. The Ministry of Finance will provide data on the stock of all budgetary arrears on a monthly basis, no more than 25 days after the end of the month, including separate line items for wages, pensions, social benefits, energy, communal services, and all other arrears on goods and services. The Treasury will report monthly data on accounts payable for state and local budgets (economic and functional classification).

53. 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.

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

55. The Ministry of Finance will provide to the IMF monthly debt (domestic and external) amortization schedules updated on a weekly basis.

56. The Ministry of Finance will provide data on external and domestic credit to key budgetary spending units as well as nongovernment units (including Naftogaz, State Mortgage Institution, Deposit Guarantee Fund and Agrarian Fund) 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.

57. 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), Social Insurance Fund, Employment Fund (detailed data on the breakdown of revenues and expenditure by main categories are expected for this Fund), Occupational Accident and Sickness Insurance 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.

58. The Ministry of Finance will report semi-annual data on the number of employees of budgetary institutions financed from the central (state) and local budgets, starting from January 2010. After any public sector wage increase, the Ministry of Finance will provide an estimate of its costs for the current and two subsequent fiscal years, for the state and local government budgets.

59. 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 deficit of the general government of the recapitalization of banks and SOEs as well as the costs associated with the payment of interests.

60. The Ministry of Finance will provide monthly data on their expenditure plans (ROSPIS) for state budget.

61. The State Tax Service (STS) and, where applicable, State Customs Service (SCS) 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 format:

<table>
<thead>
<tr>
<th>Beginning Stock</th>
<th>Netting out during month</th>
<th>I. DEFERRALS DURING MONTH</th>
<th>Write-offs (arrears written off during month)</th>
<th>Collection s of outstandin g debt at beginning of month</th>
<th>New Arrears (tax liabilities becoming overdue during month)</th>
<th>Ending Stock</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>Principal</td>
<td>Interest</td>
<td>Penalties</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax arrears</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

62. The STS 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.

63. 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 according to the definition in paragraph 11 (unsettled VAT refund claims submitted to the STS more than 74 days before the end-of-period.

64. 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.

65. The STA will provide monthly data on revenue plans (ROSPIS) for state and local budgets.

C. Ministry of Economy, Ministry of Energy and Coal Industry, Ministry of Housing and Municipal Economy of Ukraine, NURC and NERC

66. The Ministry of Economy will provide quarterly information on actual levels of communal service tariffs in all regions for major services (heating, water supply, sewage and rent) and their level of cost recovery. In addition, the Ministry of Economy, the Ministry of Housing and Municipal Economy of Ukraine, and the National Energy Regulatory Commission will provide the methodology underlying the tariff calculations for full cost recovery, including heating and gas.

67. For each month, no later than the 25th of the following month, the government (based on information by the Ministry of Energy and Coal Industry, the Ministry of Economy, STS/SCS, MoF, NERC, and Naftogaz) will provide IMF staff with information in electronic form (in an agreed format defined as “Ukraine: The Financial Position of Gas Sector”) on financial indicators in the gas and heating sectors, including prices and volumes of domestically produced (by production entity) and imported (by sources of imports) gas, sales, tariffs, arrears, payments to the budget, subsidies, and debt. 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.

68. For each month, no later than the 25th of the following month, the Ministry of Energy and Coal Industry (based on information by Naftogaz) will provide IMF staff with information “in electronic form (in an agreed format) on the cash flows and deficit of the company, as defined above. This report will break down the total cash outlays for gas imports from Gazprom by month in a separate table mutually agreed with IMF staff. This report is subjected to auditing by a reputable external auditor, first on a monthly and then on a quarterly basis, as set out in the MEFP.

69. For each month, no later than the 25th of the following month, the Ministry of Energy and Coal Industry (based on information by Naftogaz) will provide IMF staff with information in electronic form (in an agreed format and verified by a reputable external auditor) on the domestic gas used by Naftogaz for sales to households, heating utilities, budget institutions, and industries, including gas produced by SC “Ukrugasvydobuvannya,” SJSC “Chornomornaftogas,” and OJSC “Ukrnafta”.

70. For each week, no later than the Thursday of the following week, the Ministry of Energy and Coal Industry (based on information by Naftogaz) will provide IMF staff with information in
electronic form in an agreed format on the cash flow transactions of the company for the previous week.

71. For each quarter, no later than the 25th of the following month, the Ministry of Housing and Municipal Economy will provide IMF staff with information of the quantity of heating energy meters installed at a building-level measured also as a ratio to the applicable buildings.

72. For each month, no later than the 25th of the following month, the Ministry of Energy and Coal Industry (based on information by Naftogaz) will provide IMF staff with information in electronic form on the amount of Naftogaz arrears to domestic suppliers including Naftogaz subsidiaries, Ukrtransgas, Ukrgas vydobuvannya, Uknafta, Chornomornafotgas 90 days after they are due.

D. State Statistics Service

73. The State Statistics Service and Naftogaz will provide to the IMF, on a monthly basis, no later than 45 days after the end of the month, data on prices, volumes, and payments (payments data provided by Naftogaz) for imported and exported oil and natural gas by country of origin and destination.

74. 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.