

Appendix I. Letter of Intent

7054/0/2-23 від 24.03.2023

Ms. Kristalina Georgieva
Managing Director
International Monetary Fund
Washington, D.C., 20431
U.S.A.

March 24, 2023

Dear Ms. Georgieva:

1. Russia's illegal and unjustified invasion of our country continues to bring enormous human, social, and economic costs. Civilian casualties are large, over a third of the population has been displaced, and infrastructure damage is massive. Through this hardship, our people have shown courage, determination, and resilience while macroeconomic, financial, and external stability have been preserved. Strong performance under the Program Monitoring with Board Involvement (PMB) has clearly demonstrated our ability to implement sound economic policies despite these challenging circumstances. Meeting all the quantitative and indicative targets as well as all structural benchmarks helped establish a strong track record. Nevertheless, despite our efforts and the support of the IMF and other significant official external financing, we continue to face major challenges and large external financing needs.
2. Against this background and in light of Ukraine's balance of payments needs, we are requesting a 48-month Extended Arrangement under the Extended Fund Facility (EFF) from the IMF to support our economic policy priorities, in an amount equivalent to SDR11,608.25 million (577.01 percent of quota, about US\$15.6 billion), with an initial purchase of SDR2,011.83 million (100 percent of quota; about US\$2.7 billion). For each purchase intended for budget support, a special agreement between the National Bank of Ukraine and the Ministry of Finance will be signed to clarify the responsibilities for timely servicing their financial obligations to the Fund.
3. The goal of our IMF-supported program is to restore fiscal and debt sustainability as well as medium-term external viability, while also promoting long-term growth in the context of post-war reconstruction and our process of accession to the European Union. The program is designed to resolve our balance of payments problems and restore medium-term external viability not only in the baseline scenario but also under a downside scenario. We will also strive to design and implement policies that could achieve much stronger economic outcomes. The attached Memorandum of Economic and Financial Policies (MEFP) lays out in detail the economic program that the authorities of Ukraine will undertake, supported by the IMF and other international partners.
4. Given the exceptional uncertainty, the program envisages a two-phased approach. In the first phase, our primary objective is to preserve macroeconomic and financial stability within the context of the ongoing war while preparing the ground for a strong post-war recovery, including structural reforms in the fiscal area, financial sector, monetary and exchange rate policies,

governance, anti-corruption, and the energy sector. In the post-war second phase, we will deepen our structural reform agenda and implement additional macroeconomic policy reforms to restore medium-term external viability, support reconstruction and promote strong long-term growth, and accelerate our progress toward EU accession. As conditions allow, Ukraine will revert to pre-war policy frameworks, including a flexible exchange rate underpinning the inflation targeting regime. To help lay the foundation for post-war growth, we will advance reform initiatives to enhance productivity and competitiveness, including in the energy sector.

5. Our international partners have assured us of their continued support to help ensure that debt sustainability is restored and the proposed program is fully financed. In addition, we have also publicly announced our intention to undertake a debt treatment of our external public debt with the purpose of restoring public debt sustainability on a forward-looking basis. We are planning to start negotiations with bond holders in early 2024 with the objective of completing the needed operations no later than mid-2024, while a group of official creditors have committed to a two-step process for a debt treatment.

6. The progress we make in implementing our program will be monitored through reviews, initially at quarterly frequency, based on prior actions, quantitative performance criteria, indicative targets and structural benchmarks as described in the accompanying MEFP and the technical memorandum of understanding (TMU). There will be eleven such reviews to examine the progress made in carrying out the program and to agree on any corrective measures necessary to achieve program objectives. A first review of the program would be completed on or after June 15, 2023, and a second review on or after October 13, 2023.

7. We have introduced a number of measures that constitute exchange restrictions for reasons of national or international security. We have notified these measures to the Fund for approval under Decision 144. We have also introduced two multiple currency practices subject to Fund approval under Article VIII, Section 3. We request temporary approval of such measures, which are maintained for balance of payments reasons. We will gradually remove exchange restrictions as circumstances normalize, in consultation with IMF staff.

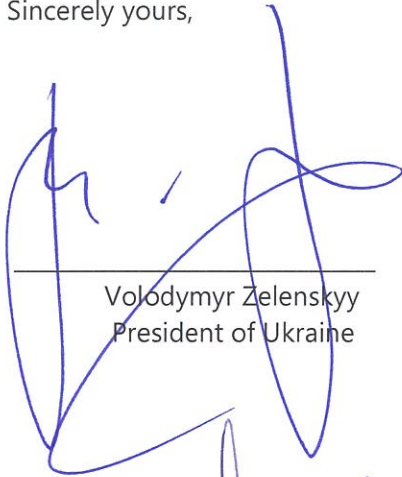
8. We believe that the policies set forth in the attached MEFP are adequate to achieve the objectives of the program, both in the baseline scenario as well as a downside. Acknowledging that these scenarios are subject to high uncertainty, we are committed to adapting our policies as conditions evolve. We will consult with the IMF on the adoption of these measures, and in advance of any revisions to the policies contained in the MEFP, in line with the IMF's policies on consultation. We will refrain from any policies that would be inconsistent with the program's objectives and our commitments presented in the MEFP.

9. We will provide IMF staff with the data and information needed to monitor program implementation, including by adhering to the data provision requirements described in the attached TMU.

UKRAINE

10. In line with our commitment to transparency, we consent to the IMF's publication of this letter, the MEFP, the TMU, and the accompanying Executive Board documents.

Sincerely yours,



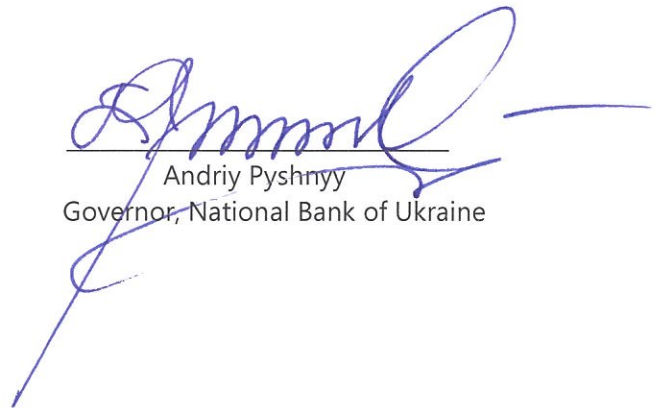
Volodymyr Zelenskyy
President of Ukraine



Sergii Marchenko
Minister of Finance of Ukraine



Denys Shmyhal
Prime Minister of Ukraine



Andriy Pyshnyy
Governor, National Bank of Ukraine

Attachment I. Memorandum of Economic and Financial Policies

March 24, 2023

I. Background, Recent Economic Developments, and Outlook

1. Russia's illegal and unjustified invasion of our country continues to bring enormous human, social, and economic costs. Civilian casualties are large, over a third of the population has been displaced, and infrastructure damage is massive. Through this hardship, our people have shown courage and resilience, while macroeconomic, financial, and external stability have been preserved. Nevertheless, we continue to face major challenges: the fiscal deficit remains very high, causing large external financing needs. Protecting core functions of the state under existing financing constraints will force us to continue navigating difficult policy trade-offs.

2. Despite the war, Ukraine's economy continues to be well-managed, and the strong performance under the Program Monitoring with Board Involvement (PMB) demonstrated our ability to implement sound economic policies. Meeting all the quantitative and indicative targets as well as all structural benchmarks helps establish a strong track-record and shows strong program ownership. It also underscores our full control of government functions. Specifically:

- We have met all three fiscal structural benchmarks, as detailed in ¶14.
- On January 26, the National Bank of Ukraine (NBU) Board formally approved Terms of Reference (TOR) for undertaking an asset quality review (AQR), viability analysis, and the diagnostics steps needed to design a Non-Performing Loan (NPL) resolution strategy. These diagnostics will be undertaken as soon as it has been deemed appropriate to do so. Formally adopting the TOR is the first critical step in the process to rehabilitate the financial sector and realign it with international accounting and regulatory standards while safeguarding financial stability.
- Finally, on January 24, the Cabinet of Ministers of Ukraine (CMU) appointed four new independent members and two out of the three state representatives for Naftogaz's new supervisory board. While the last position has yet to be filled, the supervisory board is fully functional.

3. Against this background, we are requesting a 48-month Extended Arrangement under the Extended Fund Facility (EFF) from the IMF to support our economic policy priorities in the coming years, an amount equivalent to SDR11,608.25 million (577.01 percent of quota, about US\$15.6 billion). Despite our

efforts, our strong performance under the PMB (see ¶12), and the support of our international partners, we continue to face major challenges and large balance of payment needs. In view of the exceptionally high uncertainty, our program's policy objectives envisage a two-phased approach. In the first phase, our key objective is to preserve macroeconomic and financial stability within the context of an ongoing war while preparing the ground for a strong post-war recovery, including measures in fiscal structural areas, financial sector, monetary and exchange rate policies, governance, anti-corruption, and energy sector. In the post-war second phase, we will implement an ambitious structural reform agenda and additional macroeconomic policy reforms to restore medium-term external viability, support reconstruction and promote strong growth, and accelerate our efforts toward EU accession.

4. Efforts to achieve our strategic goal of EU accession will reinforce the drivers of long-term growth and stability. Reforms to achieve accession will strengthen the economy and the institutions of Ukraine, as they are essential to creating conditions for increased investment and growth going forward. The candidate status of Ukraine implies that the choice of the regulatory regime defined by the EU *acquis* will frame our recovery and reconstruction process. This will facilitate the reconstruction efforts, in line with the European green and digital agenda. Progressive integration into the European internal market, already underway on the basis of the Association Agreement and Deep and Comprehensive Free Trade Agreement, should increase trade and stimulate revenue and technology transfer to the Ukrainian economy, thereby helping sustain the recovery.

A. Economic Outlook

5. **We expect a gradual economic recovery over the course of this year, though the outlook remains uncertain as the war continues.**

- Following a decline in output of about 30 percent in 2022, and despite attacks on critical energy infrastructure through early 2023, economic activity is showing signs of resilience. Although the war could continue through the year, we expect a gradual sequential recovery as households and firms continue to adapt to the war circumstances. Economic activity in the first quarter is expected to be flat, as quick solutions have been put in place to cope with power outages; in subsequent quarters, activity is expected to strengthen given continued growth in non-combat areas as well as base effects, under the assumption of the continuation of the grain corridor and no further escalation of the war. The pace of the recovery will be determined by the degree to which the prevailing high uncertainty weighs on private investment, the strength of consumption given the erosion in purchasing power amid contained real

wage growth, and the direction and pace of net migration. Nevertheless, by the last quarter of the year, Q4/Q4 growth could be strongly positive, and set the stage for a stronger recovery through 2024; yet, given the uncertainty, we project annual growth for 2023 in the -3 to +1 percent range.

- Inflation reached 26.6 percent y/y in end-2022, lower than initially expected. It has begun to show some signs of deceleration in early 2023, but remains elevated, at 24.9 percent in February 2023. In view of the gradual easing of supply constraints though the year, subdued consumer demand and slowing global inflation, we expect inflation to continue moderating to about 20 percent y/y by end-2023.
- The current account is expected to move to a deficit of US\$6.5 billion in 2023, following an estimated surplus of US\$8.6 billion in 2022. This reflects a widening trade balance, on account of a weaker than expected recovery in exports (given a weak agricultural harvest, loss of production capacity in metals and mining and residual supply constraints), and continued demand for imports (including for essential equipment and fuel). The services balance is also expected to widen slightly on continuing withdrawals and card payments to Ukrainian migrants abroad.

Nevertheless, continued strong external financing inflows should strengthen gross international reserves levels to an adequate US\$29.6 billion by end-2023 under the baseline scenario, equivalent to 4 months of imports.

6. The economy could rebound more quickly, particularly if the security situation improves sooner than expected. Several factors could support a stronger recovery, primarily from a decline in security risks that enables a faster recovery in sentiment, a revitalization in economic activity including from a swifter resolution of war-related supply disruptions and increased access to seaports, and the quicker return of migrants.

7. Nevertheless, risks to the outlook remain tilted to the downside, amid exceptionally high uncertainty. Security risks could persist for longer than expected, weighing on sentiment and dampening the pace of return by migrants. Insufficient donor support could also increase financing constraints, requiring difficult trade-offs. The grain corridor could be interrupted, there could be further damage to energy infrastructure or continuing power outages, or war-related supply chain disruptions could worsen, weighing on production costs and firm profitability. A continued war would continue to put pressures on our fiscal position, and fiscal and external financing gaps could widen substantially.

II. MACROECONOMIC AND STRUCTURAL POLICIES FOR 2023–27

A. Overview

8. The ultimate goal of the Ukrainian government’s economic program – supported by the IMF – is to restore fiscal and debt sustainability, while promoting long-term growth in the context of post-war reconstruction and our path to EU accession. Given the large uncertainty, our economic program entails a two-phased approach.

- In the first phase, our primary focus will be to maintain macroeconomic, external, and financial stability, in order to strengthen Ukraine’s capacity on its way to victory. Our program involves policies to ensure a robust budget 2023 coupled with a medium-term fiscal framework that would anchor fiscal policy and the assessment of financing gaps. At the same time, we will implement measures to prepare the ground for Ukraine’s post-war growth, including in fiscal structural areas, financial sector, monetary and exchange rate policies, governance, anticorruption, and the energy sector. Social spending will be safeguarded to the extent possible, also recognizing the large-scale humanitarian support from UN agencies and NGOs.
- In the second phase, once the war has tapered off, our focus will shift to more expansive reforms to entrench macroeconomic stability, support recovery and early reconstruction, promote economic growth, and thereby restore medium-term external viability. As conditions allow, Ukraine will revert to pre-war policy frameworks, including a flexible exchange rate underpinning

the inflation targeting regime. To help lay the foundations for post-war growth, we will advance reform initiatives to enhance productivity and competitiveness, including in the energy sector. Progress toward EU accession will be a major anchor for our policies.

9. We acknowledge IMF staff analysis on upside and downside scenarios, and we are fully committed to taking all necessary measures to ensure program success and a stable economy.

- Since the start of the war, we have repeatedly and decisively taken measures to respond to shocks as they have materialized, carefully balancing the need for a prompt and effective response with material social considerations. In 2022, we systematically streamlined capital expenditure and other lower priority expenditure items, and also identified additional financing. Building on this track record, we would respond decisively to a potential downside scenario, to ensure that public institutions

function effectively, taking measures as needed to preserve economic and financial stability, and maintain debt sustainability on a forward-looking basis. In downside scenarios, as illustrated in IMF staff analysis, we stand ready to take feasible fiscal measures, including identifying tax policy measures that can be effectively and rapidly implemented or spending that could be deferred pending the receipt of additional external grants or concessional support. In parallel, we will also identify additional domestic financing as needed to ensure that financing gaps are closed, without compromising economic and financial stability. These are difficult balancing acts, and we welcome the fact, as detailed in the staff report, that our partners stand ready to provide additional financial resources sufficient to close financing gaps and preserve debt sustainability; we recommitted to play our part to ensure the burden of adjustment is shared.

- We are equally focused on advancing policies that can help us achieve high and sustained growth rates. Establishing frameworks for post-war reconstruction that would enable us to absorb substantial official resources and also catalyze private capital, including foreign direct investment, could have a decisive impact. Reforms required to achieve the strategic goal of EU accession coupled with progressive integration into the European internal market through the Association Agreement and Deep and Comprehensive Free Trade Agreement would be critical components of such a strategy.

B. External Debt Strategy

10. To help restore debt sustainability on a forward-looking basis, we have publicly announced on March 24 our intention to proceed to a debt treatment on our external public debt. Our strategy seeks to help close financing gaps during the program period, reduce gross financing needs to manageable levels, including after the program, and to place public debt on a sustainable path. Our strategy is also designed to help create the necessary conditions for private sector participation in the post-war reconstruction of Ukraine and takes into account the importance of preserving financial stability. To this end, we have hired external advisors and are committed to a credible process with transparency for information and communication. In addition, financing assurances will be sought after from our international partners to ensure that the two-step approach (see ¶11, bullet 1) will restore public debt sustainability and ensure that our program is fully financed throughout its duration, including in a downside scenario.

11. The debt treatment will comprise the following elements:

- *Official bilateral debt.* Paris Club creditors have committed to a two-step process involving a 3-year extension of the current debt standstill that expires at end-December 2023, coupled with a separate assurance to deliver a final debt treatment sufficient to restore debt sustainability before the final review of the prospective IMF-supported program. We will seek treatments on comparable terms with other official creditors.
- *External commercial debt.* In August 2022, Ukraine reached an agreement with its international bondholders that included, amongst other things, a voluntary 24-month deferral of debt service on Ukraine's direct and state-guaranteed Eurobonds; similar deferrals were agreed on some non-guaranteed external commercial debt. We will begin discussions with commercial creditors in early 2024, with a goal to complete the needed debt operation no later than mid-2024 on terms consistent with the most up-to-date IMF's macro framework and the parameters of the debt sustainability assessment.

12. To support our strategy of safeguarding debt sustainability, we will also strictly limit the issuance of guarantees (Quantitative Performance Criterion, see ¶124). Adequate space will be provided to facilitate guarantees supporting critical needs, including essential loans from International Financial Institutions (IFIs) and other partners to ensure investments for critical infrastructure needs.

C. Fiscal Policy

13. In 2022, Russia's invasion forced us to manage fiscal policy under unprecedented war-related uncertainty, leading to unforeseen complexities in budget predictability and the emergence of a large fiscal deficit:

- The war had an enormous impact on expenditure, including the need to prioritize defense, security and social protection, while compressing non-priority spending. As the war progressed, we adopted several supplementary budgets to calibrate spending needs and financing sources. In this context, the financing gap resulting from the sizeable increase in defense spending in the last supplementary budget was closed by a combination of additional financing sources and under-execution of some expenditures. Thanks to timely measures taken in the context of the PMB, we managed to cap the level of general government arrears (overdue account payables) in 2022 at UAH 1,585 billion (below 0.1 percent of GDP). Consequently, actual expenditures of general government in nominal terms were almost 50 percent higher than the pre-war 2022 budget, estimated at 69.9 percent of GDP. While tax revenues (36.4 percent of GDP) were only 0.3 percent lower in nominal terms than

the pre-war budget, they have been affected by structural changes in the economy, cyclical developments and Martial Law measures that aimed to ease the impact of war on economic agents.

- The general government fiscal deficit¹ for 2022 is estimated at UAH 817.9 billion or 16.7 percent of 2022 GDP, supported by substantial external grants equivalent to UAH 481.3 billion or 9.8 percent of 2022 GDP; the deficit excluding grants was UAH 1,299.2 billion (26.5 percent of GDP). This outcome is well below the projections under the PMB and allowed us to comfortably meet the PMB's quantitative targets on the floor on the non-defense cash primary balance of the general government (excluding grants) and the indicative target in the overall cash primary balance of the general government (excluding grants). The deficit has been financed primarily by external official financing and NBU monetary financing, whereas net financing from domestic banks and non-banks turned negative. Public debt increased to slightly over 80 percent of GDP at end-2022.

14. Despite the war-related challenges, we succeeded in meeting all fiscal structural benchmarks under the PMB. In particular:

- On the tax front, we prepared and submitted for adoption by Parliament a package of tax policy and administration measures that would restore the pre-war set up of critical policy and administration components. We expect these laws to be adopted by end-June 2023.
- We have also taken important measures to prevent the accumulation of arrears (overdue account payables) during wartime. As a starting point, we have repealed the clause of the Martial law that limited the Ministry of Finance (MoF)'s powers to collect financial reports from key spending units, including local governments. Consequently, as part of the action plan, a CMU protocol decision tasked line ministries and other executive bodies, to prepare and submit reports on budget arrears accumulated at end-2022, analyze the reasons for the arrears accumulation and to develop an action plan to clear arrears outstanding at end-January 2023. As of end-December 2022, the reported stock of overdue account payables of general government is estimated at below 0.1 percent of GDP.
- With the help of World Bank technical assistance, we have prepared a concept note on social safety nets. The note identifies important reform priorities and policy options to help achieve a more targeted, adequate, and efficient social assistance

¹ The deficit is based on a cash concept, measured below the line.

system. Considering the importance of fiscal sustainability and its role in medium-term fiscal framework we will continue to work on social sector reforms bearing in mind that large social spending needs require consistency with fiscal sustainability considerations, hence the need to identify steps to ensure a sustainable social protection system in the long term.

Fiscal Policy in 2023 and Supplementary Budget

15. Our fiscal policies in 2023 will be designed to support fiscal and debt sustainability, while continuing to ensure adequate resources for core spending priorities and helping to prepare for reconstruction. Still, given the war-related uncertainty, we are committed to take all necessary measures to ringfence additional pressures and risks to the budget. We will refrain from any tax policy and administrative measures that may erode the tax revenue base in 2023 and beyond, while taking measures that support post-war reconstruction and EU accession. On the spending side, we will only revise spending categories in consultation with IMF staff and with identified financing sources.

16. Relative to the initial budget 2023, approved in November 2022, two sets of amendments are to be reflected in supplementary budgets. We have identified changes stemming from the reorganization of key spending units and earmarking of resources under the different programs that will be reflected transparently in the budget. We also expect several spending pressures to materialize. Specifically,

- **We adopted a first supplementary budget in February to introduce transparently certain changes to budget categories within pre-existing resources.** We reallocated existing resources to the newly established Ministry of the Development of Communities, Territories and Infrastructure with budget appropriations needed to start the reconstruction. We also transferred the budget program known as “Fund for the Liquidation of Consequences of the Armed Aggression” from the MoF to the new Ministry. In addition, amendments to the budget earmark new grants, including to the budgetary program supporting loans for agricultural producers, and channel savings from the Unemployment Fund for businesses’ support under the auspices of the Ministry of Economy.
- **The CMU has approved a second supplementary budget and submitted it to Parliament (prior action) to reflect modifications in revenue, spending and financing sources.** We have recognized increases in defense and security needs, while also efforts to enhance the costefficiency of our spending. First, we have identified about 8.6 percent of GDP in additional defense and security related

spending. Effective February 1, 2023, we revised the wage policies in defense and security aimed at optimizing the increase in wages while incentivizing combat recruitment. Second, following the review of 2022 social fund resources and actual outcomes of key macroeconomic variables, we have announced a 19.7 percent indexation of pensions, effective March 1, 2023. The indexation is higher than what was assumed in the original 2023 budget; it is based on outcomes of parameters feeding into the indexation formula, including inflation and average wage growth over the last three years. This measure would increase overall social spending by 2.3 percent of GDP, with no additional impact expected on budget transfers to social funds. Relatedly, the receipts from personal income tax and social security contributions are revised up by about 2 percentage points of GDP in view of the higher public sector wage bill. To cover other unexpected spending, we have added 0.3 percent of GDP to our contingency fund, bringing total amount of undistributed expenditures to 1.14 percent of GDP (partly reallocated to specific spending categories).

- After these measures, total expenditures of general government are projected at 67.7 percent of GDP, representing about 11.2 percentage points of GDP increase over the original budget. In view of the importance of our budget credibility and commitment control, the second supplementary budget will be enacted by end-April 2023 (**Structural Benchmark**).

17. **We expect the deficit excluding external grants in the 2023 budget to reach UAH 1,708.8 billion, or about 28.2 percent of GDP, which is consistent with fiscal sustainability given the support from external donors.** This is about UAH 424 billion higher relative to what was envisaged in the initial 2023 budget, and also about 1.7 percentage points of GDP higher than the estimated 26.5 percent of GDP deficit excluding external grants for 2022. To monitor our progress in this area, a floor on the non-defense cash primary balance of the general government excluding grants will be established (Quantitative Performance criterion), along with a floor on the overall cash primary balance of the general government excluding grants (Indicative Target). Moreover, to help safeguard social spending, a floor on state budget spending on social programs will be established (Indicative Target).
18. **Our tax revenues have continued to hold up well since the start of the war.** Consistent with the projected macroeconomic framework, and measures adopted at end-2022 (effective July 1, 2023), combined with measures in ¶19 of the current

MEFP, the tax revenues are estimated at 36.3 percent of GDP. We expect profit taxes to deteriorate consistent with lower corporate profits; the decline in personal income tax due to structural developments in the labor market and a decline in the public sector wage bill will be partly offset by the impact of the increase in the military wage bill. Taxes on goods and services are projected to improve as consumption recovers and measures under Martial Law are lifted.

19. We will take a number of steps to support much needed revenue mobilization.

Specifically:

- We affirm our commitment to revenue mobilization and a floor on nominal tax revenues excluding SSC will be established (**Quantitative Performance Criterion**). We will adopt the draft law prepared under the PMB by end-June (**Structural Benchmark**), effective July 1, 2023, signaling our commitment to strengthen revenue mobilization. Once adopted, the first component of the law will restore the pre-war setup for taxpayers who moved from universal tax regime (e.g., paying PIT, CIT, VAT) to the single tax. In addition, it will restore pre-war brackets of single tax eligible groups and close loopholes in application of the single tax rate of 2 percent. The law will remove idiosyncrasies of the application of the simplified tax regime by taxpayers under the single tax of 2 percent and restore the pre-war regime for these taxpayers effective July 1, 2023. The second part of the law will cancel the moratoria on tax audits, effective July 1, 2023. This should help with enhancing tax compliance. Another component of the law will provide for restoration of liability for failure to use cash registers in retail outlets, effective July 1, 2023.
- We are canceling or phasing out most of the tax deferrals introduced during the Martial Law. We have cancelled deferrals for customs duties starting from March 1, 2023, and will cancel the remaining deferrals on import duties from June 1, 2023. Moreover, we will not extend the Tax Code provisions introduced during the Martial Law that relaxed administration of taxes and fees. We will also refrain from introducing tax amnesties for the duration of the program, or from introducing any tax measures which would jeopardize our tax base. The exemptions for special equipment for electricity generation and distribution and heating supply will expire on May 1, 2023.

Fiscal Structural Reforms

20. We are committed to implementing fiscal structural reforms to anchor the mediumterm fiscal path, maintain fiscal and debt sustainability and lay the

foundations for long-term growth. As defense spending winds down, we will aim to channel the resources to spending for recovery and reconstruction as well as social safety net to address post-war needs of the society and vulnerable layers of population. Cognizant of efficient use of emerging fiscal space and the need to restore debt sustainability, we will undertake substantial changes to pension and social safety nets after comprehensive reforms in social policies including improved targeting and means-testing mechanisms for social assistance, in line with our social policy concept note (see ¶14).

21. Fiscal structural reforms are essential to meet our medium-term spending priorities and wider development goals. Thus, our reform agenda will focus on: (i) raising adequate revenue to help meet reconstruction and social spending needs through measures that enhance the efficiency, fairness and simplicity of tax system, including through a home-grown multi-year National Revenue Strategy (NRS), (ii) preparing our public investment and financial management for the post-war era, by strengthening public investment processes, the project management cycle and commitment controls, (iii) enhancing fiscal transparency and management of fiscal risks, (iv) ensuring fiscal sustainability and predictability of budget policy by restoring and strengthening the provisions of the Budget Code which stipulate the cases for budget amendments. Specifically, we will submit to Parliament a draft law to restore and strengthen Article 52 of the Budget Code, which defines the framework and cases when the budget can be amended both on revenue and expenditure side (**Structural Benchmark, May 2023**).

Revenue Mobilization Policies

22. We are committed to boosting revenues through a multi-year National Revenue Strategy (NRS):

- **In the short-term**, in addition to commitments in ¶19 of this MEFP, we will take measures to enhance tax and customs administration. In mid-February, we published the relevant parts of an independent survey of taxpayer perception and satisfaction with the State Tax Service (STS) conducted in November 2022 (with the help of Swedish International Development Cooperation Agency). With the help of the IMF and the World Bank, we will prepare an action plan, including to address the weaknesses identified in the survey, as an input into our NRS (**Structural Benchmark, end-May 2023**). We will institutionalize and strengthen the survey by enhancing its scope and representation and make it an annual exercise covering not only STS but also State Customs Service. We will approve measures to address main issues

identified in survey within a month following survey publication, as part of implementation of NRS. To understand the causes of tax arrears (overdue accounts payable) and potential means to reduce them, we commit that the STS will review the existing stock of tax arrears, establish those that are not

related or caused by Russian military aggression and occupation of Ukrainian territories by Russia, and review the possibility of arrears repayment. As a next step, the STS will prepare by end-August 2023 a detailed action plan to progressively reduce these arrears. Moreover, in addition to measures in ¶19 of this MEFP, we will identify, by end-September 2023, further revenue measures to be implemented in 2023, focusing on those that could be integrated into the revenue projections for the 2024 budget (e.g., harmonization of taxes with EU directives).

- **Multi-year National Revenue Strategy.** The CMU will adopt a decision tasking the MoF to start the preparation of the NRS (2024-2030) (**Prior Action**). The decision will declare our intention to adopt an NRS, underscore key principles and objectives for tax policy and administration both in the short-term and in the post-war reconstruction period, and lay out the steps to be taken to prepare and adopt the NRS. Subsequently, with the support of IMF TA, we will undertake gap analysis to inform a roadmap for the NRS (2024-2030) with clear revenue and other policy targets, and guidance for coordination among government agencies, donors, private sector and civil society led by MoF, to be finalized by end-July 2023. A final strategy will be adopted by the end of 2023 (**Structural Benchmark, end-December 2023**) and will include: (i) measures to strengthen tax and customs services, drawing among others on perception survey analysis; (ii) a revised simplified tax regime to address the erosion of labor taxes by moving the legal basis for labor relations to civil law ; (iii) alignment of VAT and excise duties with the EU acquis; (iv) strengthened anti-corruption measures and governance procedures to address integrity risks; (v) tax reforms that balance the need to ensure an adequate revenue base with the vital task of creating conditions for the post-war reconstruction and recovery, including much needed investments and industrial development; and (vi) reorganization of the Economic Security Bureau of Ukraine (ESBU) under subordination of the MoF.
- **Economic Security Bureau of Ukraine (ESBU).** Fighting tax evasion and enhancing governance in the tax system require a strong oversight body that can not only investigate financial and economic criminal offenses against the State, but importantly provide analytical support to identifying tax evasion on an arm's length basis. With this in mind, we are preparing amendments to the Law and reorganization of ESBU to clearly define its functions, consistent with best practices in this field,

strengthen the analytical component, and to subordinate it to the MoF. As a starting point we are revising the legal basis for operation of ESBU and will develop transparent and competitive processes for staff and management selection. We will also strengthen requirements for selection commission and will introduce clear process of competitive selection as well as streamline an activity of civil control council of the Bureau. We will develop a mechanism of attestation of the staff and introduce a contract system for employees.

Medium-term Budget Framework

23. To better prepare for post-war reconstruction and anchor fiscal and debt sustainability, we are committed to working towards restoring the medium-term budget framework. To that end, we will (i) submit to Parliament in May a draft law repealing the suspension of medium-term budget preparation (Budget Declaration) ahead of 2024 budget cycle, with effect from January 2024, (ii) present in the 2024 budget projections with key revenue and expenditures categories, along with deficit financing sources for general government for 2025-26. This will serve as a basis for preparation of budget 2025. As part of 2024 budget preparation, we will also include a fiscal risks statement including details on energy and critical infrastructure SOEs (**Structural benchmark, end-September 2023**); (iii) prepare a comprehensive MTBF (2025-2028) for the 2025 budget cycle, as prescribed by the budgetary legislation. To strengthen our expenditure planning framework, with the help of IMF TA, we will take steps to improve the strategic budgeting and costing of new public services and define mechanisms to strengthen the link between the budget and fiscal risk assessments.

Fiscal Transparency and Risks

24. We will continue taking measures to enhance fiscal transparency, address fiscal risks and strengthen commitment controls. Specifically:

- Building on the progress made under the PMB, the MoF will continue strengthening the current centralized approach to commitment control, putting us on a stronger institutional footing to prevent of arrears (overdue accounts payable) financial obligations on all levels of government, except those that were caused by the Russian military aggression and occupation of Ukrainian territories by Russia.
- As part of our continuous work, we have agreed to monitor general government arrears (overdue accounts payable) through a cumulative indicative target (**Indicative Target**), as specified in the Technical Memorandum of Understanding (TMU).

- We plan to restore regular reporting by SOEs that are not located in temporarily occupied territories.
- To strengthen risk assessment of guarantees (see also ¶12), we will prepare by September 2023 rules and regulations to tighten risk assessments to avoid abuse and introduce risk-based fees for guarantees. To safeguard our efforts for prudent debt policies, we will submit to Parliament a draft law (**Structural Benchmark, end-May 2023**) which will re-instate articles of the Budget Code that establish limits on issuance of public guarantee with clear criteria for such provision (including for priority sectors).

25. We will continue enhancing transparency in the management and spending of budgetary funds and special accounts.

- We have already prepared rules and regulations for the “Fund for the Liquidation of the Consequences of the Armed Aggression” and notwithstanding the important administrative role of the new government agency managing this Fund, we will keep control over commitments and appropriations with the MoF as prescribed by the budgetary legislation. This Fund finances a budgetary program through a special fund, and thus is subject to relevant articles of the Budget Code. We also commit to complement the existing reporting with a regular consolidated report summarizing the sources of financing and the nature of spending in one report. In this context, we commit to refrain from using the NBU profit for earmarked spending in 2024 and direct this revenue category to General Fund of the State Budget.
- *Special accounts.* We are committed to achieving maximum transparency on the operations of special accounts that have been established at the NBU to gather donations from entities seeking to support Ukraine and which provide resources to key spending units. The directions of spending of these accounts are defined in decrees and regulations issued at the onset of the war. Given that the resources are parked with monetary authority of Ukraine-NBU and their spending categories are in the domain of public expenditures, we will work towards treating programs implemented with resources of these accounts as budget programs under a Special Fund of the State Budget. We will take further steps to bring commitment controls and appropriations under the control of the MoF as envisaged by the budgetary legislation. To strengthen the legal basis of these practices, we will enact amendments to the Budget Code and related regulatory framework to enhance transparency and accountability of the special accounts and consolidate them within general

government as a Special Fund of the State Budget (**Structural Benchmark, end-May 2023**).

Strengthening Public Investment Management

26. We are committed to strengthening public investment management ahead of postwar reconstruction, building on EU4PFM and the World Bank’s Public Investment Management Diagnostic Assessment Report 2022. We will enhance the efficiency of public investment and channel resources towards projects that are providing the most value for money while supporting recovery and growth. The recent World Bank report identifies numerous areas of improvement, which if addressed in the short run can become critical inputs into achieving more transparent and efficient public investment management (PIM). To this end, with the support of World Bank TA, we will review the current PIM procedures and develop a roadmap of measures (**Structural Benchmark, end-December 2023**) so that: (i) all public investment projects follow unified PIM approaches, including PPPs; (ii) investment projects are selected on a competitive basis, with transparent selection criteria, and consistent with the medium-term budget framework; (iii) stronger powers are provided to MoF, including a clear gatekeeping role during the different stages of the investment project cycle. To further strengthen efficiency and transparency of post-war public investment and avoid multiple procurement platforms, we will adapt the national e-procurement system compliant with international competitive bidding standards used by Multilateral Development Banks.

D. External and Domestic Financing

27. We are grateful for the large, sustained support from all our international donors and partners. External disbursements of about US\$32.1 billion in 2022 were crucial to close our external and fiscal financing gaps and maintain macroeconomic and financial stability in very difficult circumstances. Continued support from the EU, IFIs, and bilateral donors remains the cornerstone of our financing strategy in 2023, and timely disbursements are vital to facilitate effective policy management and maintain economic and financial stability.

28. We are also thankful for the additional support already committed in 2023, as well as commitments to predictable financing. Firm commitments for calendar year 2023 already amount to US\$37.5 billion. Over the first 12 months of the IMF-supported program (April 2023–March 2024), the program is fully financed thanks to large official multilateral and bilateral commitments totaling US\$30.2 billion. Looking beyond March

2024, key partners have assured us of their continued support, which provides good prospects for ensuring the program will remain fully financed over the program period.

29. We intend to continue our efforts to further mobilize domestic financing to help meet our fiscal financing needs, and in a mix that supports macroeconomic stability. Our fiscal financing needs during wartime are both large and volatile. The still relatively high tax collections combined with the large external financing will continue to play the critical role in supporting our spending needs. In addition, we intend to better mobilize domestic savings to also help finance our budget, and in a manner consistent with safeguarding macroeconomic and financial stability and supporting debt sustainability. Our strategy will involve maximizing the issuance of domestic government securities in the primary market with an objective of at least covering the expected redemptions, which will allow us to eliminate monetary financing.

30. Building on the achievements during the PMB, we will further strengthen our efforts to increase net domestic bond financing over the program period.

- As of March 1, we have raised UAH 97.3 billion in the primary market in 2023, achieving a year-to-date rollover rate of 142 percent, thereby providing net financing to the budget of about US\$0.8 billion. About three-quarters of this amount has been raised through designated benchmark bonds that banks have been allowed to use to meet reserve requirements. In addition, as agreed during the PMB, issuance yields on government securities were gradually increased to support market recovery. During November–December 2022, yields increased from 18 to 19.75 percent for longer-term instruments, and longer maturity bonds were offered on some issuances in line with market demand.
- Looking ahead, we intend to continue issuing government securities with an objective of at least covering the redemptions expected in 2023 to help us meet large financing needs. The reserve requirement mechanism has been a key driver of the recent improvement in rollover rates; given the substantial liquidity available and expected in the banking system, we are committed to identifying and implementing ways to increase bank financing in a more sustainable way. This includes studying the flow of liquidity into the banking system, including on a bank-by-bank basis, to develop targeted strategies to encourage increased uptake of government bonds. To support this, we will establish a joint Working Group under the auspices of the Financial Stability Council (FSC), with participation from relevant parties, including the NBU and the Ministry of Finance, to consult regularly on strategies to mobilize domestic financing. We will make efforts to strengthen the effectiveness of the FSC, in its

current mandate, as the major platform for discussions to achieve the program's objectives. With an appropriate mix of approaches, such measures could help contribute to positive net domestic financing over the course of the program period.

- To ensure our debt management strategy is consistent with our objectives under the program, we will update and publish our Medium-Term State Debt Management Strategy (**Structural Benchmark, end-September 2023**) so that it will fully take into account developments since the start of the war. We will continue to support the development of benchmark securities and will undertake further efforts to expand and diversify the set of investors, including encouraging the return of non-residents to domestic bond markets and the restoration of market access, thereby enabling the bond market to play an active role in the reconstruction phase.

31. We are committed to eliminating monetary financing. Given the considerable risks monetary financing presents for price and external stability, we successfully contained it to the gross amount envisioned in 2022 (UAH 400 billion), and we are committed to eliminate it in 2023. Our commitment to this objective will be monitored by a ceiling on general government borrowing from the NBU (Indicative Target). If there are unexpected critical financing needs or delays in external disbursements, we will first explore additional measures, such as drawing down of excess government deposits as well as borrow additional funds from the government debt market; we will request monetary financing from the NBU only as a last resort and in strictly limited amounts.

E. Monetary and Exchange Rate Policies

Monetary Policy

32. As the war continues, we remain fully committed to safeguarding price and exchange rate stability and protecting international reserves. Following the start of the full-scale war, we undertook several emergency measures to safeguard price and external stability, including the introduction of a fixed exchange rate regime and FX controls solely for reasons of national security. As the war continues and the economy adapts to evolving conditions, our near-term objective is to continue to judiciously safeguard overall macroeconomic and financial stability, while also adjusting our policies to better serve the needs of households and firms and support the recovery. Once conditions permit, we intend to gradually move to a more flexible exchange rate, ease FX controls, and transition back to an inflation targeting framework. In this regard, we commit to prepare a conditions-based strategy (**Structural Benchmark, end-June**

2023) that, in consultation with IMF staff, will help establish and assess the prerequisites for such a move, and guide the policy measures needed to support this transition.

33. We will maintain an appropriate monetary policy stance to support steady disinflation, manage inflation expectations, and support exchange rate stability.

Over the past three months, headline inflation has been slower than expected, thanks to the easing of supply constraints, including from the liberation of occupied regions, and despite high energy costs. However, core inflation remains elevated due to pressures from production costs. Inflation expectations also appear to have stabilized, though at a high level. In 2023, with the war continuing, inflationary pressures will persist due to residual war-related supply shocks, though weak consumer demand and a broader environment of slowing global inflation should support a softening in prices.

Thus, on balance, we expect inflation to further slow through 2023 to around 20 percent. Nevertheless, upside risks to inflation outlook, most notably from the security situation, remain. In this context:

- In our March Monetary Policy Committee (MPC) meeting, we maintained the key policy rate (KPR) at 25 percent, which was appropriate in view of stabilizing but still high inflation and inflation expectations and continued supply-side headwinds on the one hand, and weak consumer demand and the still incomplete transmission of the June hike on the other.
- We will continue our efforts to strengthen the monetary transmission of the KPR. At the same time, we stand ready to adjust monetary conditions in view of the balance of risks and developments in the economic outlook, to maintain price and external stability, while establishing preconditions for the gradual easing of FX controls, transition to a more flexible exchange rate, and return to inflation targeting (see below).

34. We will continue to make efforts to manage liquidity, induce competition among banks for term deposits, and thereby strengthen monetary transmission.

The record structural surplus of liquidity (UAH 300 billion as of end-February 2023), brought about by the war, including the concentration of liquidity inflows in state owned banks, has weakened transmission of the key policy rate. As a result, the rate of return on hryvnia assets is low, which poses risks to exchange rate stability. Further, the high fiscal deficit projected in 2023 is expected to infuse new liquidity into the system through the year. Our strategy in this area is to prudently manage liquidity, while preserving space for banks to participate in government bond auctions and prevent monetary financing. We will continue to carefully monitor liquidity conditions, including the timing and size of

flows to determine the appropriate design of measures to manage liquidity and to induce banks to compete for term deposits. In this regard, we have taken the following steps:

- **Reserve requirements.** In December 2022 and January 2023, we tightened reserve requirements for current account and demand deposits of legal entities and individuals by 5 percentage points each, and an additional 10 percentage points for hryvnia and FX retail demand deposits and current accounts, effective March 11. Such measures are expected to induce banks to compete for term deposits with raising interest rates. We will continue monitoring the impact of changes to the reserve requirements on liquidity conditions (considering that a part of obligatory reserves can be met through the use of benchmark government bonds), and adjust further as needed. We also intend to fine-tune the mechanism for calculation of reserve requirements so that higher reserve requirements apply also to the ultra-short-term deposits.
- **Operational design.** We intend to adjust the operational design of monetary policy framework to restore the efficiency of the key policy rate, enhance competition in banks for term deposits, and improve the monetary transmission via revival of the interbank money market. We will introduce three-month certificates of deposit at the key policy rate; the volumes of issuance will

be limited and conditional on the stock of banks' term-deposits with maturity longer than 3 months. This will create additional incentives for banks to compete for term deposits. On balance, we intend to adjust the rate on standing facilities to help maintain an appropriate monetary policy stance in line with economic developments. These adjustments should help support the effectiveness of our sterilization operations and better link our operational framework to the KPR. Together, this will help strengthen the effectiveness of the key policy rate, which will support the eventual envisioned return to a more flexible exchange rate, easing FX controls, and inflation targeting.

Exchange Rate Policies

35. The exchange rate peg, supported by FX controls introduced solely for reasons of national security, has served as an important nominal anchor during the war. The imbalance in the FX market brought about by the war persists, and the NBU continues to be a net seller of FX (US\$28.3 billion between February 24, 2022, and end-February 2023). However, FX reserves remain strong, supported by sizable official inflows, FX controls, and recent measures undertaken to ease pressure on the cash market. In

recent months, the spread between the official and cash segments of the FX market has been narrowing despite increased FX demand related to imports for repairing the damage caused by the attacks on energy infrastructure in end-2022, stabilizing at around 10 percent through the winter, and reaching 5 percent in early March 2023. Conditional on the support of FX inflows, maintaining the stability of the exchange rate can continue to play an important role in ensuring price and financial stability.

36. We intend to maintain adequate FX reserves through the course of the program. To support external stability and in view of the large and prevailing uncertainty, the program envisages stabilizing reserves at a modest but adequate level in the near term, and gradually building them over the medium term. Progress in this area will be monitored under the program by a floor on net international reserves (*Quantitative Performance Criterion*).

37. To support FX reserves and ease pressures on the FX market, we are taking measures to increase the attractiveness of hryvnia assets. Recent measures, such as the FX-linked deposit facility and allowing individuals to purchase FX at the cash rate, have started bearing fruit. We intend to continue studying measures to stimulate the increase of hryvnia term deposits, allowing individuals to preserve the value of their hryvnia savings.

38. We intend to carefully adjust FX controls to support the economic recovery, while maintaining exchange rate stability and national security. At this point, although macrofinancial stability has been maintained, and imbalances in the FX market have somewhat eased, risks to the outlook remain high. Thus, we intend to maintain generally the existing controls on FX transactions and continue to carefully monitor and enhance the effectiveness of these measures. As flagged in the January MPC, we intend to continue finetuning FX controls to meet the needs of the economy, thereby easing pressure on the FX cash market and anchoring exchange rate expectations. This should also help, over time, eliminate the two multiple currency practices, and thereby reduce incentives for circumvention and support exchange rate stability.

39. We have extended the restriction on the repatriation of principal payments to nonresidents holders of domestic government securities after April 1, 2023; however, we will allow the repatriation of interest paid after April 1, 2023. This will balance our considerations of preserving FX reserves in the face of still elevated risks to the economic outlook as well as consistency with the standstill offered by the Government of Ukraine on holders of external sovereign debt. It will also help build incentives for nonresident investors to reinvest principal in government bonds, thereby

helping to meet our objectives of meeting fiscal financing needs and developing the government debt market.

NBU Independence and Governance

40. We intend to eliminate monetary financing, thereby upholding the financial autonomy of the NBU. In 2022, despite monetary financing of the state budget amounting to 8 percent of GDP, we have successfully sterilized the associated liquidity injection with FX sales and NBU CDs, keeping nominal base money growth contained at about 20.8 percent y/y as of end-December. Looking ahead, we intend to eliminate direct monetary financing of the budget deficit (₴131). To mitigate risks to price stability as well as safeguard central bank autonomy and enhance transparency, and in line with our intention to use monetary financing only when other options have been exhausted, the NBU and the MoF will establish, in consultation with the IMF, a framework stipulating the preconditions and procedures for short-term advances to accommodate temporary liquidity shortfalls for the duration of Martial Law by end-July 2023. We will also strive to limit indirect forms of monetary financing that are outside the core functions of the NBU, such as through the directed provision of liquidity to banks or SOEs for the purchase of government securities on the primary market. We commit to refrain from using the NBU profit for earmarked spending in 2024 and direct this revenue category to General Fund of the State Budget. Direct financing of off-budget programs by the NBU will be avoided altogether.

41. We remain fully committed to upholding the independence and institutional effectiveness of the NBU. A strong and independent NBU remains critical to achieving macroeconomic stability and will support the eventual transition back to an inflation targeting framework. In February 2023, we undertook a Safeguards Assessment, and are committed to implementing measures in line with the key recommendations. In this regard, we intend to continue adhering to our profit retention rules and ensure that the distribution of NBU profits to the state budget takes place in line with established procedures in a transparent manner.

42. Over the medium term, we intend to carefully unwind the unconventional measures undertaken to support price and external stability in wartime. Urgent wartime challenges have necessitated the use of several nonstandard measures by the NBU to support macroeconomic stability. We will strive to ensure that such measures are well-targeted, clearly communicated and time bound. When conditions permit, we are committed to developing a plan to phase out war-time measures. This will strengthen

our monetary policy toolkit, safeguard NBU credibility and independence, and thereby support our goals to eventually return to an inflation targeting framework.

F. Financial Sector

43. Our wide-ranging emergency measures have preserved financial stability. We will continue to closely monitor developments and make adjustments as necessary. Banks entered the war well-capitalized and liquid, thanks to the considerable progress achieved in cleaning up the banking system since 2014. Despite the severe impact of the war, the majority of bank branches have remained operational, online banking services are fully available to all clients with internet connectivity, the non-cash payment system is functioning normally, and liquidity has recovered for most banks. To ensure the continuity of the banking network, we introduced “Power Banking” in late 2022, a network of over 2,000 bank branches across the country that are capable of providing banking services to clients even during prolonged blackouts. The licenses of six small banks (around 3 percent of system net assets as of end-2021) have been revoked under Martial Law.

44. The emergency measures have been critical for the financial sector’s continued operations. Key measures have included the following:

- Administrative controls introduced for security reasons to preserve FX liquidity and channel it towards priority imports.
- An unsecured funding facility, introduced with a maturity of up to one year for an amount up to 30 percent of banks’ late-January 2022 retail deposits, but which was discontinued on November 5, 2022, due to a decline in usage.
- Enforcement actions on banks have been suspended for war-inflicted breaches of prudential requirements regarding capital, liquidity, credit risk, net open positions in FX and for delays in prudential reporting; audits of banks’ financial statements have been postponed, and regular bank stress testing in 2022 was cancelled.
- Loans restructured during the Martial Law period are exempt from reclassification for credit risk.
- Banks have been prohibited from related party lending (except for consumer loans granted on standard terms, available to a wide range of borrowers), capital distributions (dividend payments and share buy-backs), and bonus payments; and

- Banks have also granted payment holidays on retail and corporate loans for 3-6 months depending on the type of product and temporarily cancelled fees and commissions on cashless payments as well as cash withdrawals.

45. In preparation for a return to normality, we will update our financial sector strategy by end-June 2023 to implement a safe, coordinated, and prompt unwinding of financial sector emergency measures, while restoring accounting and prudential norms. Our 2021 financial sector strategy is being updated in consultation with IMF staff to serve as a living document requiring periodic review, modification, and action plans with implementation milestones. It will describe the future priorities for the financial system. Key elements of the strategy will include: (i) coordinated steps to safely unwind exceptional measures (we aim to unwind emergency prudential measures by end-March 2024 if conditions allow); (ii) diagnostics to quantify bank asset values and NPL resolution priorities; (iii) a framework to safely address any potential vulnerabilities; (iv) a prioritized action plan to monitor and tackle high NPL levels; (v) well-developed contingency plans to respond to potential further shocks; (vi) prioritized transposition of EU banking norms; and (vii) coordination arrangements among key stakeholders. We will publish parts of the strategy that are not market sensitive.

46. Recognizing the importance of well-informed financial sector policies, the NBU is preparing to undertake detailed bank diagnostics. These are critical to ensure prudent and consistent valuation of banks' assets, informing triage and the modalities of eventual balance sheet cleanup. In line with the Terms of Reference adopted by the NBU in January 2023, we will: (i) complete an independent asset quality review (AQR) once conditions have stabilized; (ii) carry out a subsequent bank viability assessment, and (iii) prepare a prioritized interagency NPL resolution action plan by end-June 2024. The current prohibition on bank capital distributions will remain in place until after the independent AQR findings have been fully reflected in banks' regulatory ratios and financial statements. To better understand current banking system conditions and to inform supervisory priorities, the NBU's banking oversight teams will undertake an asset valuation and solvency assessment of banks comprising 90 percent of banking system assets by end-December 2023 and will share results with IMF staff.

47. We are determined to take the necessary steps to continue to preserve financial stability and limit potential fiscal cost of any interventions. Our priorities will focus on continued preservation of financial stability whilst ensuring financial and operational readiness to respond adeptly to shocks. The NBU and Deposit Guarantee Fund (DGF) will prepare contingency plans to respond to further potential high-impact events in their respective areas, in consultation with key stakeholders and IMF staff. The

Financial Stability Council will adopt by end-June 2023 those plans related to preparation for potential adverse rulings from the constitutional challenges against the DGF Law and the Bank Resolution Law (Law #590), and an updated contingency plan to prepare for litigation risks concerning past bank resolution decisions. We will also prepare a bank rehabilitation framework in consultation with the DGF and IMF staff (**Structural Benchmark, end-March 2024**). It will include: (i) financial backstops; (ii) regularly updated bank recovery and resolution plans; (iii) improving the DGF's financial position; and (iv) aligning the NBU's frameworks for counterparty eligibility in monetary policy operations and for lender-of-last-resort operations with international best practice. We shall also continue working on our longstanding priorities including: (i) reducing historical non-performing loans (NPLs) while maximizing recovery of economic value; (ii) recovering of value from assets of resolved banks; and (iii) developing the regulatory framework for the nonbank financial sector and financial markets.

48. All our decisions will be consistent with our overall strategy to reduce state ownership in the banking sector. Any decision that has the potential to increase state ownership in the banking sector will be taken in consultation with IMF staff and be strictly limited to matters related to national security decisions during the Martial Law period and preserving financial stability.

49. We are fully committed to further strengthening regulation and supervision. In recognition of the importance of preparation for EU accession, we have undertaken a gap analysis relative to the EU Capital Requirements Directive. We will aim to close the identified gaps in the regulatory capital structure by end-September 2023 and other gaps by end-September 2024.

- To strengthen governance and oversight, we will take the following actions (**Structural Benchmark, end-September 2023**): (i) separate the related-parties-unit from banking supervision; (ii) strengthen Supervisory Committee decision-making by implementing "supervisory panels" as a consulting body to the Committee that will provide additional independent review and challenge to recommended decisions, promote horizontal communications among stakeholders as well as consistency in decision making, and highlight issues that need special attention; and (iii) In recognition of the critical importance of onsite inspections, we will resume scheduled inspections for both banking and non-banking institutions, while ensuring NBU discretion on matters related to staff safety.
- We recognize the need to promptly transition to a risk-based supervision approach. In this regard, we will implement a supervisory risk assessment methodology to

inform supervisory engagement priorities (**Structural Benchmark, end-June 2024**). We will apply this methodology to all banks and prepare a supervisory action plan by end-December 2024. We will also adjust the organizational structure for bank supervision to leverage efficiencies as we transition to a risk-based approach; and further improve professional capacity of bank supervision, which will include the development of professional profiles needed and a multi-year training program for new hires.

50. We will strengthen the legal, regulatory, and supervisory framework for non-bank financial institutions (NBFIs) and financial markets. The NBU required all NBFIs (apart from credit unions) to disclose their owners and those with non-transparent ownership structures to change their ownership structure by October 2021. We will continue to monitor and take supervisory actions against those NBFIs that do not meet this requirement. We also recognize the need to promptly transition to a risk-based supervision approach for NBFIs and will prepare a supervisory risk assessment methodology that distinguishes between the types of the NBFIs, by end-September 2024. To strengthen NBFIs supervision, we have passed legislation on Financial Services and Financial Companies (#5065) and Insurance firms (#5315). We will adopt legislation by end-May 2023, which will amend the Law on the National Securities and Stock Market Commission (NSSMC) to enhance the NSSMC's powers, independence and institutional capacity, and its cross-border and domestic cooperation mandate. We will ensure that this law takes into account the mandate of other regulators, that it meets the objectives outlined in ¶22 of the September 2016 MEFP and that it allows Ukraine to become a signatory of IOSCO's multilateral MoU by end-December 2024 with full implementation of the other provisions of the law by end-December 2025. To strengthen regulatory effectiveness for NBFIs, we will adopt the Credit Unions Law (#5125) by end-June 2023, and we will exclude NBU regulations for NBFIs from the scope of Law of Ukraine "On principles of state regulatory policy in the field of economic activity".

51. Finally, we will continue our efforts to recover value from former shareholders of failed banks. We reconfirm our commitment to continue efforts to recover value from assets of failed banks and to abstain from any interference with the current asset recovery strategies of the largest bank nationalized in 2016 and of the DGF.

G. Governance and Growth

Promoting Medium- and Long-Term Growth

52. **We remain committed to advancing a structural reform agenda that will lay the foundations for robust post-war growth and pave the path for EU accession.** Ukraine will need high and sustained rates of economic growth after the war, to restore its economy and recover standards of living for its population as swiftly as possible. This will require unprecedented amounts of investment and rebuilding of human capital. The public sector will play an important role in the recovery process, and we fully acknowledge that measures to increase efficiency and transparency of public sector governance will be critical to facilitate much-needed donor financing. We also recognize that a large part of investment will have to come from private sources, and that reforms and measures aimed at ensuring rule of law and level playing field for businesses will be critical to attract the needed investments as well as encourage the return of migrants. In the near term, our efforts will focus, inter alia, on strengthening the public procurement system with a view to align it with the EU acquis and implementing measures to deregulate economic activity and improve the business climate. Furthermore, we envision a strong, stable banking sector being an important pillar of the reconstruction phase. Market-based financial intermediation will help enable the private sector in mobilizing savings toward the recovery, which would help enhance productivity and support high and sustained growth.
53. **Our strategy for post-war reconstruction will meet the highest standards of transparency and accountability.** In coordination with international partners and civil society organizations, we plan to take full advantage of digital technologies including through a platform that will provide timely information to transparently track and analyze reconstruction-related procurement processes and expenditures (see ¶26). The reconstruction strategy will integrate and implement mechanisms to prevent and identify corruption risks, and refer cases, as appropriate, for follow-up by the anti-corruption institutions. Comprehensive audits of the use of reconstruction funds, performance audits of selected individual projects (including project costs, deliverables and outputs), and timely publication of audit reports will also be key features of the strategy.
54. **We will take steps to reform and enhance the Anti-Monopoly Committee of Ukraine (AMCU).** By end-September, we will adopt amendments to strengthen the legal framework of the AMCU to enable it to effectively implement its capacities to promote

market competition and combatting monopolistic practices. In that context, we will identify and implement necessary steps to help ensure that Ukraine's anti-monopoly framework does not inappropriately discourage public investment or state aid, above all in reconstruction projects. By end-December, we will also submit a new draft law to parliament ensuring AMCU's institutional independence, enhancing appointment procedures for key officials, and strengthening its enforcement powers.

Anti-Corruption and Rule of Law

55. We remain firmly committed to preserving independent, competent and trustworthy institutions to combat high-level corruption. The anti-corruption institutions - the National AntiCorruption Bureau of Ukraine (NABU), Specialized Anti-Corruption Prosecutor's Office (SAPO), the High Anti-Corruption Court (HACC), and the National Agency for Corruption Prevention (NACP) – have continued to operate unabated despite the war. In line with our commitments under the PMB, eight new additional SAPO prosecutors were onboarded in December 2022. In addition, new members constituting a quorum of the High Council of Justice (the judicial self-governance body) were appointed in January 2023. Independent and effective anti-corruption institutions are critical to pursue and recover illicit proceeds from corrupt activities and provide strong foundations for the transparency and accountability of post-war reconstruction funds.

56. Strengthening the rule of law, fighting against corruption, and addressing money laundering are essential elements for Ukraine's path to EU membership. These efforts will also promote public trust and donor confidence, and we will avoid any backtracking from the progress made to our anti-corruption and judicial reform efforts. At the same time, we will take steps to ensure that our framework does not inadvertently dissuade competent professionals with integrity from taking civil service roles. We will prioritize the following structural reform measures:

- *Strengthening Effectiveness of Anti-Corruption Institutions.* The CMU appointed a new head of the NABU last March 6 following an open, credible, and transparent process conducted by the Selection Commission (**prior action**). In line with a broader reform of the forensic expert system for criminal law enforcement, we will ensure that the NABU will have access to competent, independent and speedy forensic examinations by experts, to enable it to effectively conduct its investigative mandate. We will also further strengthen the capacities of the SAPO, including enhancing its institutional autonomy within the constitutional framework. To that an end, following an analysis

of the SAPO framework, legislation will be adopted to: (a) improve the selection procedures of the SAPO head and key officials; (b) strengthen its capacity to regulate its organizational activities; and (c) establish mechanisms for discipline and accountability of SAPO leadership (including performance evaluation and a periodic external audit conducted by external experts with international experience) (**Structural Benchmark, end-December 2023**).

- *Targeted Restoration of Asset Declaration Obligations.* A law will be enacted to restore the obligation of public officials (but not directly involved in the mobilization and war efforts) to submit and disclose their asset declarations during Martial Law and reinstate the function of the NACP to examine and verify the asset declarations (**Structural Benchmark, end-July 2023**). To support the filing of public officials, we will enhance the asset declaration system to allow for automatic populating of information from other linked databases and registers while keeping with the public official's obligation for truthful and timely submission of simplified asset declarations during the period of the Martial Law (**Structural Benchmark, end-October 2023**).

We will subsequently undertake consultations with stakeholders to explore publishing during Martial Law summary information about the assets and liabilities of official persons who hold positions of high and especially high responsibility under the Law on Prevention of Corruption, balancing the need for transparency and safeguarding personal security. The NABU and SAPO will be provided full, direct, and confidential access to these submitted asset declarations to facilitate efforts on investigation and prosecution of corruption, bribery, and illicit enrichment. Once Martial Law is lifted, the asset declarations system will be fully restored, including disclosure requirements for all covered public officials, risk-based verification of asset declarations, and public access to asset declarations.

- *Ensuring effective risk-based AML regime.* One of the key goals of the AML/CFT framework is to prevent, detect and deter the laundering of proceeds of corruption through effective risk-based AML/CFT supervision. With the help of IMF capacity development, the NBU will start work immediately to develop guidelines, consistent with the FATF standards, for risk-based supervisory on-site activities to ensure that financial institutions and other covered non-bank institutions are complying with AML/CFT obligations in line with their risks. In parallel, in light of the November 2022 amendments to the AML/CFT framework, we will further amend the AML/CFT law to re-establish the obligations of financial institutions to implement enhanced due diligence measures on politically exposed persons on a risk-based approach consistent with the Financial Action Task Force (FATF) standards (**Structural**

Benchmark, end-September 2023). We will also improve the effectiveness of the beneficial ownership regime to enhance transparency in public procurement, detect conflicts of interest through transparent ownership structures, and prevent the misuse of companies. By end-September 2023, we will adopt amendments to the relevant legislation to align the definition of beneficial owner with the FATF standards, and implement verification measures to ensure accuracy, adequacy and up-to-date beneficial ownership information submitted.

- *Advancing Rule of Law and Judicial Reforms.* We will complete the appointment for the remaining vacancies of the High Council of Justice by ensuring open and transparent proceedings by the Ethics Council. As part of our commitments towards joining the EU, we will adopt a law by end-June 2023 that will provide an effective solution to break ties with the sixmember Advisory Group of Experts, when vetting candidates to the Constitutional Court. Following the dissolution of the Kyiv District Administrative Court in December 2022, we will establish a new court by end-December 2023 that will hear administrative cases against national state agencies (e.g., NBU, NABU, NACP) by judges who have been properly vetted for independence, competence and integrity.
- *Governance Diagnostic.* To help anchor governance reforms in the reconstruction phase, we will seek IMF technical assistance to conduct after the Martial Law is lifted a new Governance and Corruption Diagnostic to take stock of progress made since the 2014 Diagnostic, assess corruption vulnerabilities and governance weaknesses linked to key state functions, and laying out future reforms in a post-war scenario.

Corporate Governance in SOBs and SOEs

57. We remain committed to strengthening the governance of state-owned banks (SOBs). We recognize that sound governance arrangements are key to preserve financial stability, protect public finances, and maintain the confidence of our international partners. Under previous Fund-supported programs, we have undertaken substantial reforms to improve the governance and oversight of SOBs, including adoption in 2018 of a dedicated SOB framework within the banking law. For each SOB, we have: (i) appointed a majority-independent supervisory board, and (ii) signed a Memorandum of Understanding that defines the relationship between each SOB and the MoF and CMU as shareholder. We remain fully committed to upholding the spirit of governance reforms in SOBs and ensuring their operation on a professional and commercial basis, without political interference on operational matters. New procedures

for appointments to SOB supervisory boards were adopted ahead of the current cycle of recruiting independent supervisory board members. In this regard, we will ensure that operational continuity and institutional memory are preserved at each SOB, and the NBU will rigorously apply its fit and proper assessment framework to the new supervisory board members put forward following the recent selection process. We will also introduce a procedure for conducting annual business planning and performance assessments for all SOBs. The first performance assessment will be conducted for each of the banks in 2024 (based on 2023 performance). In August 2024, the MoF will publish its first annual assessment's key findings, together with Cabinet's actions to address them findings.

58. We are committed to continue strengthening corporate governance in SOEs.

To that end, we will adopt by October 2023 the SOE corporate governance law #5593-D to bring the SOE corporate governance framework in line with OECD Guidelines on Corporate Governance of SOEs, including by strengthening the accountability and broadening the powers of supervisory boards so they have the ultimate authority to appoint and dismiss CEOs. In line with our commitments under the PMB, we have appointed members of the supervisory board of Naftogaz, which is now fully operational. Furthermore, we are committed to implement the needed corporate governance reform at the Gas Transmission System Operator (GTSO) and we will implement all the following steps: (i) transfer the GTSO shareholding from MGU to the Ministry of Energy and adoption of the new charter (Structural Benchmark, end-July 2023); and (ii) selection and appointment of a supervisory board for the GTSO by end-October 2023.

Energy Sector Reforms

59. We are strongly committed to implementing a timely and ambitious reform agenda aimed at tackling the longstanding structural challenges in the energy sector that have been compounded by the war. Once the war winds down, this will inter alia require restoring and enhancing competition in wholesale and retail gas markets. Furthermore, ensuring sustainability of the system and reducing quasi-fiscal liabilities will necessitate a gradual increase in gas and electricity tariffs to cost recovery while allocating adequate and well-targeted resources to protect vulnerable households.

60. The immediate priority should be to contain the adverse impact of the war on the sector. This implies ensuring sufficient resources can be channeled to key large SOEs. In the short term, the menu of options includes tariff increases, securing external financing, or transparent and exceptional direct budget support.

- Ukrenergo has secured significant external financing support that should be sufficient to cope with the most urgent repair of the electricity grid. The recent increase in the TSO tariffs for 2023 is also helping, although the operator costs remain under pressure, including from the additional ancillary costs stemming from the increased use of gas for electricity generation purposes and from the need for full payment of the electric power generated from renewable energy sources.
- Low domestic consumption, resilient domestic production, and a mild winter have limited the need for gas imports for this season. For the next heating season, about 2 bcm of additional gas imports could be required under the baseline. Naftogaz has made progress in securing additional financing for gas imports through the EBRD and bilateral donors. In case of a liquidity shortfall, including in a downside scenario where more gas imports would be needed, we will assess the amount of PSO compensation in 2023 based on actual documentary proven expenditures of Naftogaz verified by the State Audit Service and other relevant stakeholders. The relevant calculations will be finalized by end-August 2023. The potential spending pressure from gas imports and PSO compensation will be accommodated through an adjustor on fiscal balance targets, subject to the above assessment, available financing, and capped at UAH 60 billion (about 1 percent of GDP).
- The GTSO revenues have been impacted by many factors including low tariffs, large unauthorized gas offtakes, payments to Naftogaz, and a drop in transit revenues since May 2022, as one key entry point is located in occupied regions. The GTSO is reducing expenditures, but the current liquidity crisis could require budget support. In parallel, once corporate governance reforms are finalized (see ¶158), the company's strategy should be adjusted to reflect its new operating environment by rightsizing the system and identifying alternative sources of supply.

H. Program Monitoring

61. Program implementation will be monitored through reviews (initially at higher frequency), quantitative performance criteria, indicative targets, and structural benchmarks. We commit to provide to IMF staff all the data needed for adequate monitoring of the program, including the data and information detailed in the attached TMU. The complete schedule of reviews is presented in the companion staff report. Performance will be initially assessed through high frequency reviews and then move to semi-annual reviews. The quantitative conditionality is detailed in Table 1. The program will also be monitored through the continuous performance criterion (PC) on the non-accumulation of external payments arrears and standard continuous PCs. Prior

actions and Structural Benchmarks described in this MEFP are summarized in Table 2. The first and second reviews are tentatively planned for July 2023 and October 2023, based on quantitative performance criteria for end-April 2023 and end-June 2023, respectively, and corresponding structural benchmarks.

Table 1. Quantitative Performance Criteria and Indicative Target
(In millions of Ukrainian hryvnia, unless otherwise stated)

	2022		2023				
	December		March	April	June	September	December
	QT	Act.	PMB (IT)	QPC	QPC	IT	QPC
I. Quantitative Performance Criteria 1/2/							
Floor on the non-defense cash primary balance of the general government, excluding budget support grants (- implies a deficit)	86,950	402,002	-8,240	258,352	318,502	337,998	96,737
Floor on net international reserves (in millions of U.S. dollars) 3/	15,000	17,879	11,500	15,500	15,500	15,500	15,500
Floor on tax revenues (excluding Social Security Contributions)				451,700	696,400	1,094,700	1,679,170
II. Indicative Targets 1/ 2/							
Floor on the overall cash balance of the general government, excluding budget support grants (- implies a deficit)	-1,425,762	-1,298,698	-506,476	-356,500	-638,300	-1,046,000	-1,708,700
Ceiling on general government borrowing from the NBU 4/ 5/	388,500	388,400	-7,600	-2,551	-2,573	-1,153	-704
Ceiling on general government arrears				6,000	4,500	3,000	1,600
Floor on social spending				187,000	258,100	372,600	499,600
III. Continuous performance criteria 1/2/							
Ceiling on non-accumulation of new external debt payments arrears by the general government				0	0	0	0
Ceiling on publicly guaranteed debt				20,000	37,000	37,000	37,000
IV. Memorandum Items 1/2/							
External project financing	51,733	48,700	13,713	23,718	28,453	42,660	56,852
Budget support grants	461,940	456,270	182,843	178,363	268,871	404,632	422,916
Budget support loans	577,814	562,446	164,559	324,762	531,646	713,899	945,126
Interest payments				39,052	129,702	183,898	279,937
NBU profit transfers to the government	19,700	19,700	71,000	71,600	71,600	71,600	71,600
Net financing of the general government deficit by commercial banks 2/ 5/ 6/	-101,223	-77,323	-5,434	51,533	175,213	266,420	329,692
Government bonds for the purposes of bank recapitalization and DGF financing	0	0	0	0	0	0	0
Called guaranteed debt principal 2/	15,000	2,645					
Spending from receipts resulting from sales of confiscated Russian assets and transfers of bank accounts				8,000	17,000	17,000	17,000
Spending on gas purchases, PSO compensation and transfer to GTSO				10,000	30,000	45,000	60,000

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 for 2023 are cumulative flows from January 1, 2023, unless otherwise noted.

3/ Calculated using program accounting exchange rates as specified in the TMU.

4/ For end-April, calculated cumulative from April 1, for end-June from May 1, for end-September, July 1; and for end-December, October 1.

5/ Cumulative flows from April 1, 2023

6/ Calculated using the projected redemption of government bonds for 2023 as of March 11, 2023

Table 2. Prior Actions and Structural Benchmarks			
	Prior Actions	Sector	Timing
1	Appointment of the NABU Head following an open, credible, and transparent process consistent with the law	Governance/ AntiCorruption	Prior Action
2	The CMU to approve a second supplementary budget, and submit it to Parliament	Fiscal	Prior Action
3	The CMU to adopt a decision tasking the MoF to start the preparation of the NRS (2024-2030)	Fiscal	Prior Action
	Structural Benchmarks	Sector	Timing
1	Enact the second supplementary Budget 2023	Fiscal	End-April 2023
2	Submit to Parliament a draft law to restore and strengthen Article 52 of the Budget Code to minimize ad hoc amendments to the budget law (MEFP ¶21)	Fiscal	End-May 2023
3	Adopt the draft law on tax policy and administration prepared under the PMB (MEFP ¶19)	Fiscal	End-June 2023
4	Update and publish the Medium-Term Debt Management Strategy to align it with the program objectives (MEFP ¶30)	Fiscal	End- September 2023
5	Present in the 2024 budget declaration projections for major revenue and spending categories and sources of deficit financing for 2025-2026, and a fiscal risks statement including details on energy and critical infrastructure SOEs (MEFP ¶23)	Fiscal	End- September 2023
6	Prepare an action plan, including to address the weaknesses identified in taxpayers' perception survey, as an input into National Revenue Strategy roadmap (MEFP ¶22)	Fiscal	End-May 2023
7	Submit to Parliament a draft law which will re-instate articles of Budget Code that establish limits on issuance of public guarantee with clear criteria for such provision (including for priority sectors) (MEFP ¶24)	Fiscal	End-May 2023

Table 2. Prior Actions and Structural Benchmarks (concluded)

	Structural Benchmarks	Sector	Timing
8	Enact amendments to the Budget Code and related regulatory framework to enhance transparency and accountability of the special accounts and consolidate them within general government as a special fund of the State Budget (MEFP ¶125)	Fiscal	End-May 2023
9	Review the current PIM procedures and develop a roadmap of measures so that: (i) all public investment projects follow unified PIM approaches, including PPPs; (ii) investment projects are selected on a competitive basis, with transparent selection criteria, and consistent with the medium-term budget framework; (iii) stronger powers are provided to MoF, including a clear gatekeeping role during the different stages of the investment project cycle (MEFP ¶126)	Fiscal	End-December 2023
10	Adopt National Revenue Strategy by the end of 2023 (MEFP ¶122)	Fiscal	End-December 2023
11	Prepare a conditions-based strategy to move to a more flexible exchange rate, ease FX controls and transition to inflation targeting (MEFP ¶132)	Monetary and Exchange Rate	End-June 2023
12	Transfer the GTSO shareholding directly to the Ministry of Energy and adopt the new charter (MEFP ¶158)	Energy/ Corporate Governance	End-July 2023
13	Enact the law to restore asset declaration of public officials not directly involved in the mobilization and war efforts and reinstating the NACP's function to examine and verify them (MEFP ¶156)	Governance/ AntiCorruption	End-July 2023
14	Amend the AML/CFT Law to re-establish enhanced due diligence measures on politically exposed persons consistent with the riskbased approach consistent with the FATF standards (MEFP ¶156)	Governance/ AntiCorruption	End-September 2023
15	Simplify the asset declaration system through linking with other databases and registers consistent with the public	Governance/ AntiCorruption	End-October 2023

	officials' legal obligations to make truthful and timely submissions (MEFP ¶56)		
16	Legislation will be adopted to enhance the institutional autonomy of the SAPO, specifically, on the selection procedures, capacity to regulate organizational activities, and mechanisms for discipline and accountability (MEFP ¶56)	Governance/ AntiCorruption	End- December 2023
17	Strengthen bank governance and oversight by: (i) separating the related-parties-unit from banking supervision; (ii) implementing "supervisory panels" as a consulting body to the Supervisory Committee; and (iii) resume scheduled inspections for both banking and non-banking institutions, while ensuring NBU discretion on matters related to staff safety (MEFP ¶49)	Financial Sector	End- September 2023
18	Prepare a bank rehabilitation framework in consultation with the DGF and IMF staff (MEFP ¶47)	Financial Sector	End-March 2024
19	Implement a supervisory risk assessment methodology to inform supervisory engagement priorities (MEFP ¶49)	Financial Sector	End-June 2024