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ВАЛЮТНИЙ РИНОК В УКРАЇНІ: ПРОБЛЕМИ ТА ВИКЛИКИ

Розкрито поточний стан та динаміку валютного ринку України. Висвітлено основні тренди діяльності банків як ключових гравців на валютному ринку України. Проаналізовано політику регулятора (НБУ) в частині нарощення золотовалютних резервів. Акцентовано на відсутності підстав для широкої лібералізації валютного ринку.

Ключові слова: валютний ринок, валютний курс, золотовалютні резерви, валютні інтервенції, заходи регулювання, лібералізація, адміністративне регулювання, "нова нормальність", деріскінг, кореспондентські відносини ринку.

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CURRENCY MARKET IN UKRAINE: PROBLEMS AND CHALLENGES

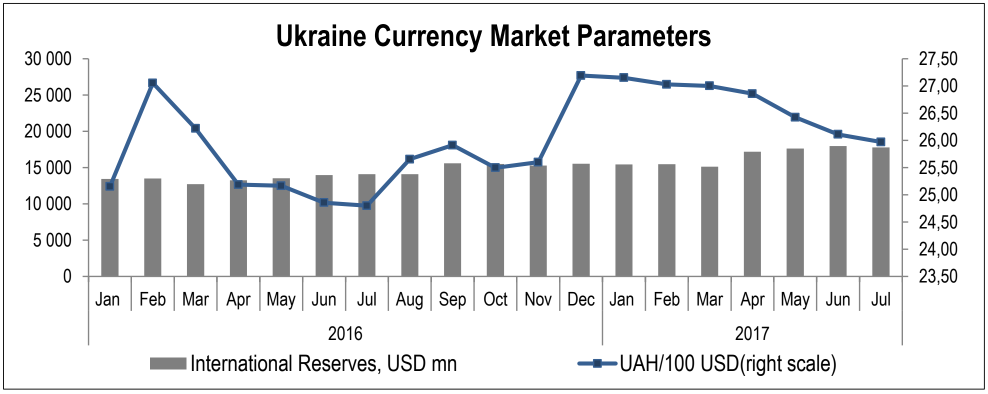
The article conveys the current state and dynamics of Ukraine currency market. As banks are deemed key currency market players the authors have shown macro-trends in the banking system reflecting banks' currency market activity. The authors also outlined influential factors of the Ukrainian foreign currency market and applied to the "new normal" concept as the reference point after the fundamental change of market conditions for further monitoring of the market development.

Key words: currency market, exchange rate, FX (international) reserves, currency interventions, regulatory measures, liberalization, administrative regulation, "new normal", de-risking, correspondent relations.

Current Ukrainian currency market developments as at early August 2017 continued the positive path with hryvnia appreciation by 0.6% in July and by almost 5% compared to end-2016, owing summer market stability and expected support of the exchange rate during 2017.

According to the official statements, in 2017, currency market will be propped up by the US$ 1.9 bn IMF tranche expected in 4Q, official creditors' funds and funds from the projected Eurobond issue.

The international reserve accumulations of the National Bank of Ukraine (NBU) increased by 15% since end-2016 to overall US$ 17,795 mn as at end-July, 2017, to finance 3.6 months of future imports and fully perform current NBU operations and Ukraine's liabilities. The NBU foreign currency interventions balanced at net purchase of US$ 1.4 bn for January-July 2017. The July monthly increase was due to foreign currency denominated state bonds as well as net FX purchase interventions of the Central Bank. At the same time, large state bills service payments weighed down the Central Bank reserves.



Source: the National Bank of Ukraine.

Regulatory measures in force to influence the foreign currency market include the still acting (till mid-December 2017) provision of 50% mandatory sale of export revenues, regulations on external debt redemption, foreign remittances and cash FX purchase. The regulator has recently eased procedures for purchase and transferring foreign currency under the state bills-related operations with foreign investors.[1] Also the regulator eased procedure to repurchase Eurobonds issued abroad to finance loans for banks provided by non-residents to such banks, which now becomes permitted under the general license for foreign exchange operations and without the need to obtain an individual license. The latter measures though not directly impacting the FX market might have a calm-down effect on the market by clarifying the procedures for import and export of capital.[2]

The Ukrainian currency market remains under multisided influence both directly and indirectly. The ***upward*** impulse comes from:

– the 18% growth of domestic investment in 2016 compared to the decline in previous reporting periods, hypothetically supporting confidence of economic agents;

– steel, iron ore and grains[3] global prices at good positions;

– the NBU had a positive interventions balance in 2016 thus upholding its international reserves [purchase of net $1.6bn to boost gross reserves by 17%yoy to $15.5bn or 3.6 months of imports in 2016].

Negative impact can be materialized from:

– the declined exports, including in the course of forced geographical rebuild of export structure aligned to trade wars with Russia in 2016[4] and the uncertain export prospects for the future;

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[1] Approved by the Regulation of the Board of the National Bank of Ukraine No.65 dated 18.07.2017 On Approving Amendments to the Regulation of Procedure and Terms of Foreign Currency Trade.

[2] Approved by the Regulation of the Board of the National Bank of Ukraine No.77 dated 08.08.2017 On Amendments to the Instruction to the Procedure of Individual Licensing to Make Investments Abroad

[3] According to the United States Department of Agriculture, in the marketing season *2015/2016*, *Ukraine held strong positions among global grains' exporters, and namely 3rd by barley exports, 4th by coarse grains and corn exports, 5th by wheat exports.* Regardless record world grain harvest and related price fluctuations, the demand remains strong for wheat from Asia and China as well as for corn from the Middle East and Asia. In the 2016/2017 season starting from July 2016, the Ukrainian grain exports grew by 12.3%yoy, highest shares delivered to Egypt, China and South Korea, India, Saudi Arabia, Italy and Spain.

[4] Significant contraction of trade volumes with Russia by 29.1%yoy to mere 11.6% share in total merchandise turnover in 2016 versus 16.3% in 2015 in result of the military conflict urged Ukraine to relocate its external activities to the European Union and diversify **trade breakdown** by partner country. Merchandise turnover with the EU surged by 8.1%yoy to 40.5% in 2016, favored by trade liberalization with the EU and implementation of the new production standards and requirements. Exports to the EU reached 37.1% of total, mostly to Poland, Italy and Germany.

– during the coming years Ukraine is scheduled to redeem both private and public debt much desired to be rolled over;

– sovereign and quasi-sovereign debt redemptions in 2017-19 if not rolled over might disturb the market, especially under high downward fluctuations of the Ukrainian hryvnia exchange rate.

In ***substantiating the need for currency market regulation,*** it is important to outline the following. According to its Money and Credit Policy 2017 and Mid-Term Guidelines (Approved by the NBU Decision of 21.12.2016), the National Bank of Ukraine has committed to support the floating exchange rate, but with flattening overall rate volatility by occasional interventions while also tending to reduce its administrative regulations. So far, while the rationale for the widespread liberalization is absent, administrative measures, which include fixing a certain exchange rate level or range, accumulation in favorable periods of the centralized reserves as the intervention instrument and supporting the transmission mechanism of the discount rate in the money-and-credit policy, remain necessary and are applied to in order to prevent the uncontrolled rate movements as impediment to perform the NBU hryvnia stability-focused function.

Our statement among other considers the M0 aggregate is high at 28% (effective for June 2017) as estimated by the NBU witnessing strong market dependence on cash and spread of informal cash settlements and on the other side correlating with interbank credit crunch, all resulting in presumable volatility. Moreover, external funding which includes foreign direct investment and borrowings has lately somewhat drained whereas exports are upheld mainly by agri- and metallurgy sector production of low processing level. During 1H2017, net FDI inflow decreased to US$ 1.2 bn compared to US$ 2.1 bn in 1H2016, banks' borrowings also decreased among other in view of the premature redemptions. Overall capital inflows to the developing countries fell by several times to below 2% of GDP compared to pre-crisis period before 2008-2009 (namely 7% in 2007), and access to capital markets remains restricted due to Ukraine's low sovereign ratings and currency risks. Obviously, Ukraine should preserve its relations with the IFIs and the IMF.

Till end-2017, the NBU is said to buy small amounts from the F/X market, and the amount of the reserves will depend on possible Eurobond issuance.

The notable folding of the interbank flows in Ukraine and globally is owing to the ***de-risking of the correspondent network*** and the refusal or precautions of some large global banks to effect settlements of their customer banks' LORO-correspondents (the banks' customer banks). The trend is expected to impact trade settlements of the developing markets like Ukraine and requires immediate decisions as to the further functioning of the trade globalization.

Future considerations are relied on the statements of the Complex Development Program for the Financial Sector of Ukraine till 2020 and the Reform Principles[5] developed within the authorities' aim at economic de-regulation, which however should coexist with the efforts to straighten the exchange rate volatility curve. As a rule, less volatile exchange rate calms down concerns of investors and outher economic entities'.

Within the breakdown of economic development factors, the pre-conditions of currency dynamics and expectations – household consumption and exports were on notable downturn in previous periods, but are awaited to grow slowly. Retail sales have been on

Ukraine receives nearly 3.0% of GDP in export revenues from transportation services (largely pumping Russian gas to Europe) while importing from Russia large volumes of coking coal and chemical products. Further trade deterioration with Russia and/or re-escalation of the conflict in the east would be a drag on the economy.

[5] Approved by the Regulation of the Board of the National Bank of Ukraine No.391 dated 18.06.2015 On Approval of the Complex Program of Ukraine Financial Sector Development till 2020.

the increase recently (by 5.8%yoy measured for the period of January-April 2017 data versus 4%yoy for 2016) witnessing satisfactory consumption, exports are expected to grow in 2017 (already showing +28%, computed for 1Q2017 versus 1Q2016).

An obvious thing is that the development and diversification of exports by products and countries of destinations, with a contribution of export- and energy efficiency-support programs will pave the way to currency market stability through promoting export revenue.

Bank assets' and deposits' currency structure and dynamics proved to be both the influential factor and reflection of currency market stance. Presently, the NBU meets the urgent need for elaboration of FX hedging instruments by implementing the IFRS 9 standard in early January 2018 and amendments to the chart of banking accounts to set forth the reflection of hedging instruments. But in practice, over 85% banks do not have the approved action plan to implement IFRS 9, and 18% of banks have estimated their reserves under the related losses, according to the NBU survey. The general enacting of the IFRS standards as obligatory for the Ukrainian banks has been done since December, 1, 2015. Effective since end-1H2017, the amendments to the chart of banking accounts enable accounting of derivatives and embedded derivatives, their revaluation reserves and trade results.[6]

Another issue however is that the demand and effective market for these instruments are under question and will need a separate regulation.

For retail currency market players and banks, foreign currency controls are being eased[7]. Now individuals may without limitations transfer funds abroad under non-trade operations, and banks may exchange currency without regard to the Ukrainian Currencies Classifier group on the interbank as well as on the international markets, whereas formerly the exchange transactions were allowed only withing a same Classifier group with some exceptions.

Said amendments give certain space for banks to regulate own liquidity and currency position and waive concerns of the individuals, however remain subject of manual market regulation and backtracking in case of vulnerability.

It is known that banks constitute a market-maker group on the currency market of Ukraine and have a large share of their revenues obtained from foreign currencies trade and revaluation.

In 1Q2017, according to the NBU data of the banks' profit and loss statements, total FX transactions result made up UAH 1,118 mn [US$ 41 mn, -29% vs.1Q2016], and total FX revalue result grew and amounted to UAH 1,175 mn [compared to US$ 44 mn negative result in 1Q2016].

Massive banking system cleanup and the need to recapitalize the remaining banks has become another factor of currency market uncertainty. By early 2017, over 80 banks had been liquidated or initiated to be liquidated [as at 1Q2017, 90 banks actually operated on the market]. As estimated, about 50% of total refinancing in 2014-16 was provided to liquidated banks and with most probability went to the currency market. On the other hand, the deposit repayment received from the Deposit Guarantee Fund might have also been directed to the currency market. Currently, certain changes in the landscape of the banking sector are noted, and namely lower number of banks have the greater role, and in particular on the currency market.

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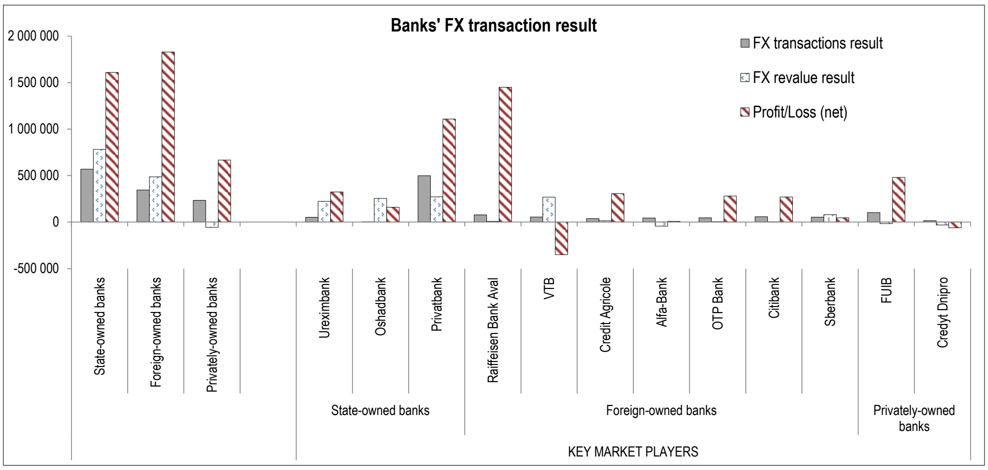
[6] The Regulation of the Board of the National Bank of Ukraine No.39 dated 24.05.2017 On Changes to Certain Legislative Acts of the National Bank of Ukraine.

[7] The Regulation of the Board of the National Bank of Ukraine No. 44 dated 30.05.2017 on the Regulating Procedure and Terms of Foreign Currency Trade.



Source: the National Bank of Ukraine.

The Ukrainian economy and financial sector, and within these frames, the currency market now show the "new normal" stance, meaning the coming back to pre-crisis conditions is not expected any more. The current free float of the Ukrainian hryvnia determines the cost of external debt and the need for a new regulations aimed at ensuring confidence and effective operation of the economic agents. The currency controls over the inflow and outflow of funds should be considered through the prism of financial monitoring and compliance regulations practices.

There is also an outstanding need for upgrading Ukraine's image on the international arena, which task not the least thing would be the support of the Ukraine currency value in order to achieve foreign investors' confidence and the re-opening of international capital markets and widening correspondent relations of the Ukrainian banks in order to ensure uninterruptable international settlements.

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