

ICPS newsletter®

Hryvnia upturn not for long

As in Spring 2008, the hryvnia has shifted its position relative to the dollar. The main reason for the strengthening of the hryvnia is different, however, writes International Centre for Policy Studies Economist Oleksandr Zholud for Gazeta.ua, an online publication. Whereas in 2008 the hryvnia appreciated mainly because of the National Bank of Ukraine's battle with inflation, this year the main reason is the release of the second tranche of the IMF's Stand-by loan

The main reason for the appreciation of the hryvnia in Spring 2008 was the National Bank of Ukraine's effective battle with inflation by reducing the supply of hryvnia on the market. Foreign currency that made its way to Ukraine at the previous exchange rate simply could not be exchanged. At first glance, this year seemed to be seeing the same phenomenon.

If we look at monetary data, then all forms of monetary supply, from cash in circulation to the broad money mass have been growing more slowly this year than last. Some positions have even fallen. Still, it is worth remembering that money is merely a means to make the exchange of goods and services easier. If the country's economy is in a recession the likes of which it hasn't seen in a decade, it is hardly surprising that less money is needed to service it.

Tranche Two: US \$2.8bn to the rescue?

This year, however, the main reason is the release of the second tranche of the International Monetary Fund's Stand-by facility for Ukraine. This tranche filled NBU reserves and, for the first time, the State Budget, for a total of US \$2.8bn. This means that the National Bank currently has more resources at its disposal to smooth out any spikes on the currency market.

The money that went to the Budget is supposed to go to cover the national debt. Moreover, according to top officials, this means not only external, but also internal debt. Given that Ukraine's domestic debts are largely in hryvnia, this means that part of the tranche will be sold on the interbank exchange. This will increase the supply of dollars and so expectations have strengthened the market for hryvnia.

What is important is not only what the IMF did, but what it did not do. Back in April, the NBU approved a slew of resolutions that force commercial banks to reduce their surplus of hard currency. Whereas earlier, reserves were partly in foreign currency in order to stave off losses on hard currency loans, now banks have to make them all in hryvnia and sell off any hard currency that is free.

Because this raises the risk-level in the banking system, leading to a greater need for insurance against both deadbeat borrowers and exchange fluctuations, the banks expected the IMF to be openly critical of this new policy. However, the Fund left this issue completely without comment, which is now being interpreted as its silent approval.

Stronger hryvnia not based on an improved economy

As far as we can see, the appreciation of the hryvnia does not reflect any real improvement in the economic situation in Ukraine, but only a number of temporary factors. Among these are the state of the balance of payments, the budgetary system, the financial state of public corporations, and the general economic situation in Ukraine give no reason, so far, to speak about the hryvnia remaining at the levels it has reached.

Notably, so far, the NBU has not been buying up currency on a monthly basis as was the case in 2008, but selling it. In other words, the market is currently unable to ensure the necessary level of hard currency supplies. The main problems with Ukraine's economy have not disappeared by some miracle after the receipt of the tranche. Foreign trade remains in a deficit, there is practically no inflow of foreign capital to Ukraine, and the situation with

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the financing of the Budget, Pension Fund and Naftogaz Ukrainy remains unclear.

The exchange rate is a fairly unpredictable phenomenon and it could indeed remain at its current levels under certain circumstances. Growing world demand for Ukrainian commodities or a weakening dollar relative to other currencies are two possible bases for such a result. Still, under the current circumstances, this seems less likely than a return of the hryvnia to its previous positions in the nearest while. ■

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