



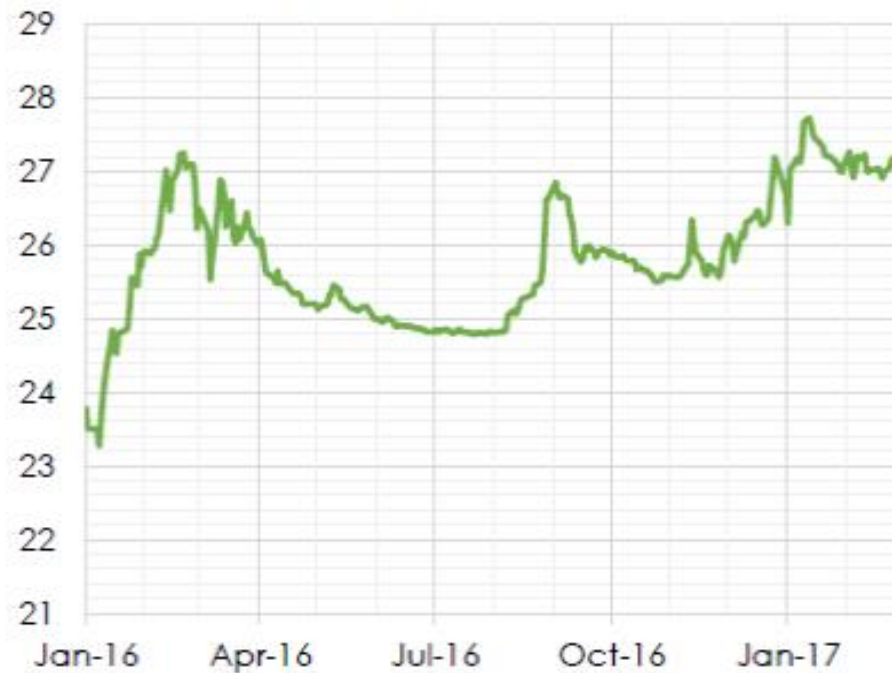
March 2017

Currency market in Ukraine: problems and challenges in 2017

Andriy Shkliar
Kateryna Anufrieva

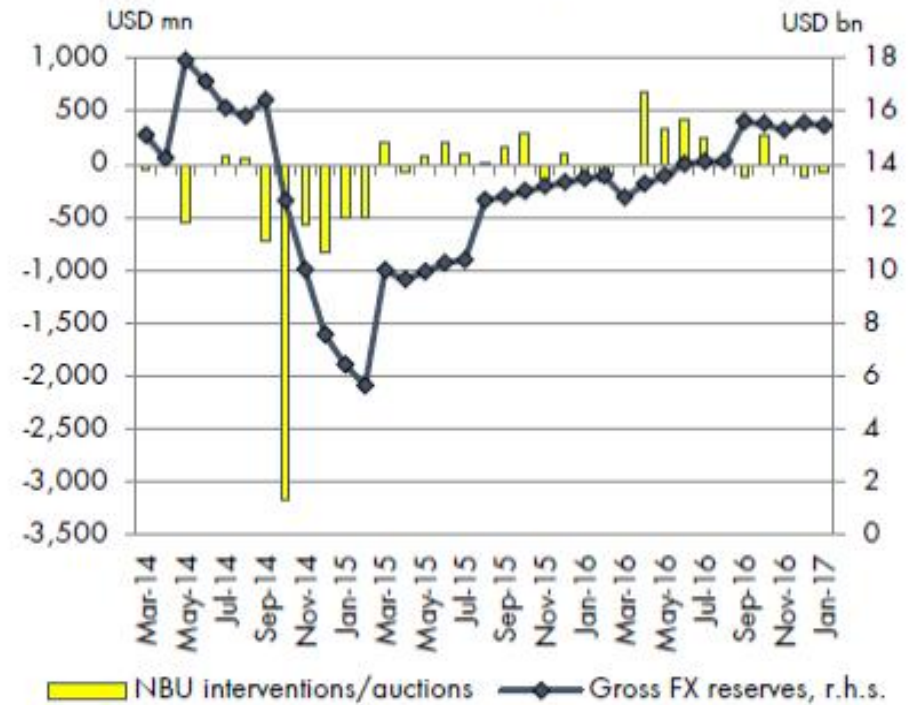
WHAT HAVE CHANGED?

Official USD/UAH rate



Source: National Bank of Ukraine, RBI/Raiffeisen RESEARCH

Gross international reserves



Source: National Bank of Ukraine, RBI/Raiffeisen RESEARCH



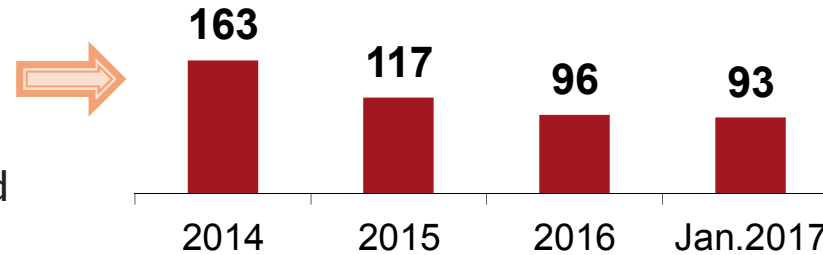
SYSTEM CLEANUP

IMPRESSIVE NUMBERS

- ✓ **43% decline** of number of banks, **ca.70 banks** since end-2014
- ✓ **Over 80 banks** liquidated or initiated liquidation
- ✓ **50%** or UAH67.9bn/**USD2.5bn** of total **refinancing** in 2014-16 provided to **liquidated banks**

REASONING

- ✓ **Up to 10 banks** liquidated for explicit reason of non-performance (non-compliance with capital and other economic reqs, non-performing creditors' claims)
- ✓ **4 banks** for non-compliance with AML
- ✓ **5 banks** for non-transparent ownership structure



CAUTIONS:

Refin provided

Deposit repayment by Deposit Guarantee Fund

Performing loans / Customers' funds



Paid by state
Directed to FX market



Funds possibly illegally withdrawn

OUTCOME:

- ✓ **need for new bailout concept [93 banks left]**
- ✓ **owners/controllers' responsibility**
- ✓ **possible banking system rebuild**



CURRENCY MARKET REGULATION CONCEPT

	ACTIONS / EFFECTS	PRE-CONDITIONS	POST-CONDITIONS
RESTRICTIVE APPROACH	<p>NBU: 108 regulatory acts</p> <p>Currently: 65% sale of export revenue; mandatory LC confirmed by investment-rated banks for import payments</p> <p>Caution: manual regulation</p>	<ul style="list-style-type: none"> • Military conflict in the Eastern regions of Ukraine • Bank system cleanup • Economy and FX market turbulence in 2014 • Exports were on notable downturn • Large scheduled redemptions 	<ul style="list-style-type: none"> • Ceased investment and bank correspondent relations • Shadow market, pessimistic expectations, speculations
RATIONAL APPROACH	<p>EU-FINSTAR project: new FX regulations [unambiguity, reference to market and external economy conditions, responsibilities]</p>	<p>Preconditions for regulations / possible scenarios envisaged by law</p>	<ul style="list-style-type: none"> • Calm down investors' concerns • Upgrade Ukraine's image on the international arena • Straighten exchange rate curve • Demand for hryvnia
LIBERALIZATION	<p>Economic de-regulation</p> <p>Currently: eased settlements with investors, broad rights of FX purchase, canceled register of import-related FX purchase</p> <p>Caution: populist actions</p>	<ul style="list-style-type: none"> • External debt rollover [\$2.2bn foreign financing in 2016] • Diversification of exports by products and geography, favorable terms of trade [forced geographical rebuild; global steel prices on slight rise; Ukraine's leading positions by grains' exports] • Domestic investment growth [+18%yoy in 2016] • Political consensus 	<p>Uncontrollable market, speculations – if pre-conditions not met</p>



NEW NORMAL* IN UKRAINE



Ukraine: Sovereign ratings

LCY rating	S&P	Moody's	Fitch
Long-term	B-	Caa3	B-
Short-term	B	n.a.	n.a.
Outlook	Stable	Stable	Stable

FCY rating	S&P	Moody's	Fitch
Long-term	B-	Caa3	B-
Short-term	B	n.a.	B
Outlook	Stable	Stable	Stable

Latest assessment	Jun-16	Nov-15	Nov-16
-------------------	--------	--------	--------

Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Changes in the landscape of the banking sector (lower number of banks greater role of the shadow banking sector)

Blockade of occupied Donbass legitimized economic contraction in Ukraine (reduction of exports and foreign exchange earnings by USD2bn, the de facto final loss on assets tubing)

Fixing the "new normal" level of sovereign risk (get used to double-digit cost of sovereign borrowing and forgetting about substantial inflows on the financial account)

* – term created by Mohamed A. El-Erian, CEO of PIMCO (\$1.5 trillion in assets under management)



SUMMARY

- 1 Main purpose of regulation: to calm down investors' concerns, upgrade Ukraine's image on the international arena, straighten exchange rate curve, increase demand for hryvnia.
- 2 Banks liquidation: Opaque and unprecedented elimination of banks from the market affects the stability of the banking system and FX market as deposit repayments are directed mainly on FX purchase
- 3 Bailout regulation: since the bailout process and banks liquidation has become rather influential on FX market – need for new bailout concept, owners responsibility.
- 4 “Smart” liberalization: talks on currency liberalization in current terms of short-sighted
- 5 New normal in Ukraine: adoption of abnormal stress conditions as basic – a new reality in the coming years



▶ Thank you for attention!

- ▶ Institute for Economics and Forecasting
- ▶ 26, Panasna Myrnoho, Kyiv
- ▶ 01011, Ukraine
- ▶ +38(044) 280-1234

