



# MEMU Supplement

## Should people worry about devaluation?

Since mid-August, household demand for foreign cash - mostly US dollars - on the foreign cash market has been rising constantly. The rush for foreign currency has increased the price for cash US dollars at exchange points to 5.41-5.42 UAH/USD in October, which is a significant deviation from the official rate of 5.31 UAH/USD.

Initially this phenomenon was seen as primarily due to the usual seasonal trend to purchase cash foreign currency to replenish savings after the summer vacations, and to the growing political uncertainty on the eve of the presidential elections. However, the persistence of the high demand for foreign currency makes political uncertainty the much more plausible explanation. Besides, cash US dollars have always been a traditional saving instrument for many Ukrainians. Thus, people decided to save more in foreign currencies after the prices on some food products recently rose.

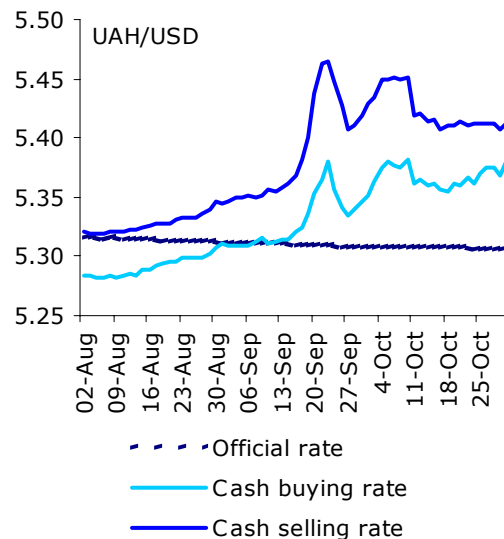
To prevent a shortage of foreign exchange cash, the NBU undertook several steps. Firstly, it allowed banks to buy US dollar notes on the interbank foreign exchange market for sale on the cash market. Secondly, it started selling cash US dollars to commercial banks at the fixed rate of 5.315 UAH/USD, so that the banks could satisfy the growing demand for cash US dollars. During October the NBU sold USD 0.4 bn cash USD dollars to commercial banks, and announced that it stands ready to sell an additional USD 1.0 bn before the end of the year if necessary. Thirdly, the NBU introduced an administrative restriction of 2% on the deviation of banks' cash rates from the official rate. In addition, the NBU conducted a series of impromptu inspections of exchange points to ensure that the cash rate restrictions were being observed.

The first two measures implemented by the NBU can be considered as positive steps to eliminate foreign currency shortages. However, the price regulation for US dollar notes made the banks quite reluctant to sell foreign currency on the cash market. There is anecdotal evidence that significant shortages of cash foreign currency persist, and that the exchange points refuse to sell it. Moreover, several banks have started regulating cash sales, establishing a daily maximum amount of cash foreign currency that any one person can buy, and requiring buyers to produce personal identification (e.g. a passport). It is claimed that these measures are meant to prevent speculation and the development of a black market. In sum, the overall NBU policy to overcome these shortages appears to be unsuccessful. Instead, the NBU policies should focus on promoting confidence in the hryvnia and curbing panic, by explaining that there are no economic reasons to devalue the hryvnia. The NBU needs to emphasize its considerable reserves and its willingness to use them.

Due to strong external position the NBU foreign reserves are at sufficient level to cope with situation. Purchase of excess foreign currency supply allowed the NBU to accumulate USD 10.7 bn of foreign reserves as of end of October. Although increased inflation pushes the hryvnia towards real appreciation, Ukraine's exports competitiveness remains strong due to the hryvnia's devaluation vis-à-vis the euro. It is forecast that by year end the current account surplus will reach USD 6.4 bn, or more than 10% of GDP. Because of this, there is no reason to expect a sharp decline in net exports, and hence a lower foreign currency inflow.

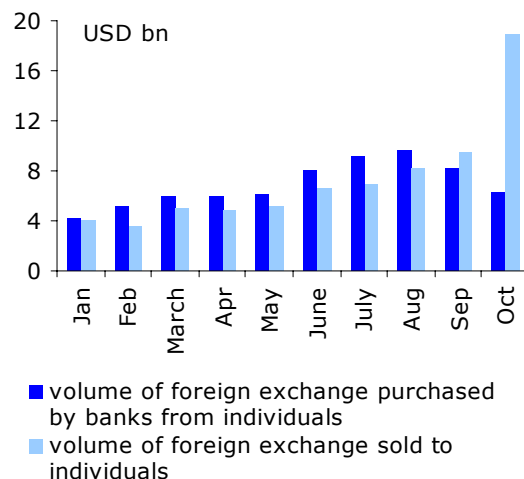
To sum up, it is evident that at present there are no economic reasons for hryvnia devaluation and, thus, for panic. The NBU should further continue informing population that inflation and devaluation are not directly related. It is also advisable to stop administrative regulations (like recent 2% restriction), which deter natural renewal of stability at the market through market forces.

**UAH/USD Exchange Rate**



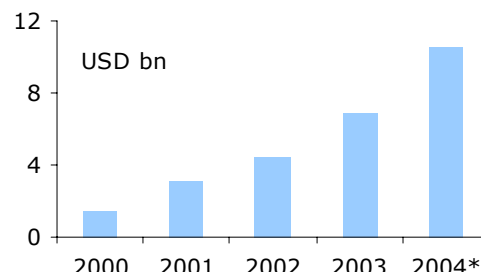
Sources: NBU, Ukrainian financial server

**Volume of Transactions at Cash Foreign Exchange Market in 2004**



Source: National Bank of Ukraine

**NBU International Reserves**



\* as of the end of October 2004  
Source: National Bank of Ukraine

Authors:  
Halyna Herasym (IER, Kyiv)  
Veronika Movchan (IER, Kyiv)  
Ricardo Giucci (DIW, Berlin)



## Quarterly Trends

<b>National accounts</b>		<b>Q2 02</b>	<b>Q3 02</b>	<b>Q4 02</b>	<b>Q1 03</b>	<b>Q2 03</b>	<b>Q3 03</b>	<b>Q4 03</b>	<b>Q1 04</b>	<b>Q2 04</b>
GDP	UAH bn	49.9*	64.1*	63.3*	51.5*	60.0*	75.6*	77.1*	64.1*	78.6*
GDP (real)	% yoy	4.7*	4.3*	6.1*	8.4*	10.0*	6.8*	12.1*	12.3*	13.2*
Households consumption (real)	% yoy	2.0*	8.9*	11.2*	10.2*	14.4*	11.2*	13.6*	15.5*	16.0*
State consumption (real)	% yoy	5.4*	-18.8*	2.9*	15.0*	17.8*	19.2*	9.0*	-3.6*	-2.0*
Gross fixed capital formation (real)	% yoy	7.8*	3.8*	5.7*	9.0*	20.4*	24.3*	9.0*	23.3*	4.3*
Exports of goods and services (real)	% yoy	2.5*	15.3*	17.0*	9.9*	9.8*	9.8*	11.6*	16.5*	15.2*
Imports of goods and services (real)	% yoy	1.4*	10.4*	6.7*	13.8*	16.2*	17.4*	17.7*	14.5*	7.0*
Agriculture, hunting, forestry (real)*	% yoy	12.1*	2.1*	1.3*	4.0*	-13.7*	-22.5*	6.7*	-4.2*	1.2*
Manufacturing industry (real)*	% yoy	10.6*	8.0*	11.5*	12.0*	15.4*	23.0*	20.1*	22.7*	15.5*
Construction (real)*	% yoy	-7.9*	-1.2*	2.7*	18.2*	24.8*	30.9*	16.9*	29.8*	30.6*
Trade, repair services (real)*	% yoy	5.3*	8.8*	3.5*	7.2*	15.1*	22.6*	29.6*	23.5*	35.1*
Transport (real)*	% yoy	0.5*	7.9*	11.0*	10.0*	11.5*	15.9*	11.7*	11.0*	8.9*
<b>Balance of payments</b>										
Current account balance	USD bn	0.6	0.8	1.0	1.1	0.7	0.7	0.4	1.7	2.3
Current account balance	% of GDP	6.7	6.4	7.9	11.2	7.0	5.0	3.0	14.3	16.5
Trade balance in goods	USD m	87	155	225	309	-42	-155	-381	767	1460
Trade balance in services	USD m	244	247	382	387	399	362	409	542	307
Current transfers	USD m	441	517	520	500	526	574	584	465	746
Direct investment (FDI)	USD m	119	156	300	238	454	390	329	310	574
Portfolio investments	USD m	-311	-592	-520	-825	640	-444	-293	60	-409
Gross international reserves	USD bn	3.4	4.1	4.4	4.6	6.2	6.7	6.9	7.9	9.6
<b>Fiscal indicators</b>										
Consolidated fiscal revenues	% of GDP	29.9	28.2	28.1	31.6	31.7	30.1	28.6	28.1	27.9
Personal income tax	% of GDP	5.2	4.9	4.9	5.7	5.7	5.3	5.1	4.5	4.3
Enterprise profits tax	% of GDP	4.3	4.1	4.3	5.7	5.1	4.8	5.0	4.0	4.1
Value-added tax	% of GDP	6.6	6.4	6.1	6.2	6.3	5.8	4.8	6.4	5.9
Excise tax	% of GDP	1.9	1.9	1.9	2.1	2.2	2.1	2.0	2.2	2.2
Consolidated fiscal expenditures	% of GDP	28.4	26.4	27.3	27.7	29.2	27.9	28.8	26.1	27.5
Current expenditures	% of GDP	na	na	na	na	26.3	24.2	24.3	23.1	23.6
Capital expenditures	% of GDP	na	na	na	na	3.0	3.7	4.4	3.0	3.9
Consolidated fiscal balance	% of GDP	1.5	1.7	0.7	3.8	2.5	2.2	-0.2	2.0	0.4
Privatization receipts	% of GDP	0.4	0.3	0.3	0.6	1.0	1.0	0.8	1.5	3.9
<b>Labour market</b>										
Average wage (real)	% yoy	20.0	21.2	17.7	12.3	19.1	19.9	14.9	23.0	17.8
Household income (real)	% yoy	61.3	100.8	65.6	-1.18	8.57	9.96	8.66	15.7	13.0
Unemployment rate (ILO methodology)	%	9.7	9.2	11.1	9.4	8.8	9.2	9.0	9.0	9.6
<b>Banking system</b>										
Monetary aggregate M0	% yoy	48.0	46.0	35.8	32.4	37.0	30.5	25.3	29.1	25.6
Monetary aggregate M2	% yoy	39.5	46.5	42.2	47.8	54.6	49.9	47.6	45.4	44.8
Household deposits in national currency	% yoy	90.1	103.6	72.5	73.4	74.7	65.0	66.1	69.4	67.3
Household deposits in foreign currency	% yoy	47.4	55.1	59.3	71.2	70.2	70.4	77.5	67.0	61.7
Com. bank credits in national currency	% yoy	34.5	42.3	54.4	63.7	71.2	73.0	61.7	56.8	52.1
Com. bank credits in foreign currency	% yoy	32.1	37.3	40.3	44.1	48.4	57.7	60.9	63.6	56.2
Long-term com. bank credits	% yoy	70.6	85.8	92.5	110.6	156.4	164.0	157.9	141.7	102.7
Long-term com. bank credits	% of total	23.5	25.3	28.2	31.3	37.4	40.1	45.0	47.4	49.3
Average lending rate on national cur. credits	% p.a.	25.0	23.5	21.8	18.0	17.2	17.2	17.7	17.2	16.6
Average lending rate on foreign cur. credits	% p.a.	12.9	11.9	11.3	12.5	12.6	11.7	10.9	12.2	12.1

SOURCES: National Bank of Ukraine, State Committee of Statistics, State Treasury, Ministry of Finance, IER estimates

\* change in value added

\* preliminary

### Notes:

**yoy** year on year change

**p.a.** per annum