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BALANCE OF PAYMENTS AND MACROECONOMIC STABILITY IN TRANSITION ECONOMY: A COMPARATIVE ANALYSIS

Abstract

The paper studies the dynamics of balance of payments in Ukraine and traces back the origin of its decline. The author analyzes the effect of macroeconomic policy upon internal and external stability with special emphasis on correlation of the balance of payments and the level of monetary reserves. She compares the experience of payment equilibrating in transition economies in the context of practicing it in Ukraine.

Key words:

Balance of payments, payment equilibrating, current account, capital account and financial account, monetary reserves, macroeconomic policy, macroeconomic stability, actual effective policy, transition economies, direct and portfolio investments.

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I. Dynamics of Balance of Payments in Ukraine

A generalized evaluation of economic climate in a country and efficiency of its economic ties is normally based on balance of payments. The balance of payments functions as a macroeconomic model, which methodically reflects the economic operations between the national economy and other countries. Such a model is designed so that to develop and implement reasonable exchange rate and external economic policies, analyze and forecast the situation on the commodity and financial markets. External equilibrium in transition economies takes on special significance when moving to stable economic growth.

An undecided problem for most transition economies in the period of reformation is that the balance of payments is generally boosted through increase in balance of current account. Thus, the balance of current account in Ukraine considerably increased in recent years. Its surplus amounted to $1.81 billion in the first half of 2003. However, the balance of capital account and financial account was negative, and its deficit made $168 million in the corresponding period.

Many scientists discuss the expediency of supporting a positive balance of current account. This is due to the fact that many transition economies tended to increase their revenues and decrease their negative balance of current account in the period of stabilization.

Considerable gap in the balance of payments of the countries of Central Europe, former Soviet Republics, and Ukraine during systemic transformations of the 1990-s was subsequent upon a sweeping crisis with a downswing in production among its manifestations. Drastic liberalization was a shock for demand and supply, which brought forth the decline in production and the rise in prices. Notwithstanding great differences in the reformation policies, the accumulative drop in production by 40–60% was not only essential, but also identical in almost all of the countries.

The economy of Ukraine had a propensity to grow in the third quarter of 1999 – it was the first time since declaration of independence of Ukraine when the State Statistic Committee has registered 0.2% growth of real GDP as compared with the previous year. Positive progress in industrial production came to pass in the same year, when depressing tendency of 1990 – 1998 was shattered. Improvements in agrarian sector emerged no sooner than in 2000.

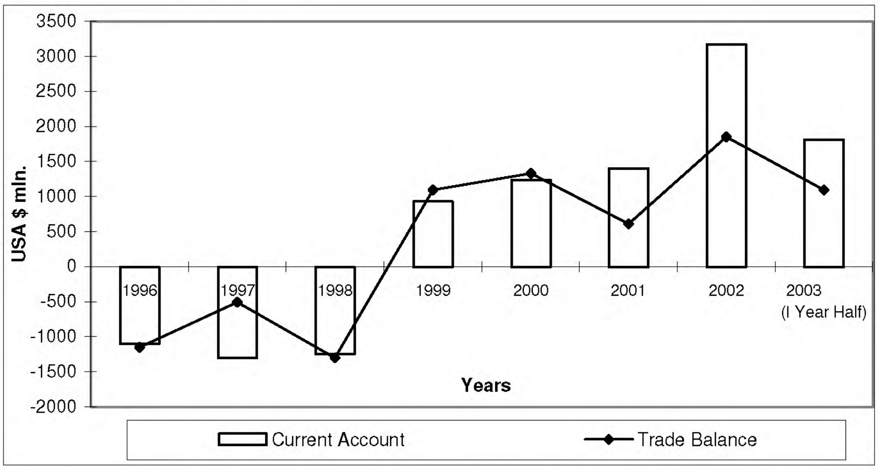
It is worth noting that stable rise in production took place in recent years. In the first half-year of 2003 its growth was by 13.8% higher than that for the corresponding period in 2002. Growth of production was to a certain extend encouraged by expansion of crediting as a result of reduction in interest rates.

National economic growth influenced balance of payments. Thus, in 1999, the deficit of balance of payments made USD 185 million, while in the following year, its surplus amounted to USD 571 million, and in 2001 the positive balance made twice as much.

Increase in balance of payments occurs due to balance of current account (Figure 1). At the same time, the balance of capital account and financial accounts remains negative.

Figure 1.

Dynamics of Balance of Current Account and Balance of Trade in Goods and Services, 1996–2003.



Source: Bulletin of National Bank of Ukraine, Dec 2002, balance of payments in Ukraine, 2002, balance of payments in Ukraine for the first half year of 2003.

The dynamics of balance of current account shows that starting from 1999 it has tended to grow which for the most part, was preconditioned by increase in exports. Rapid growth of the balance in 1999 was due to unprecedented increase of positive foreign trade balance as a result of increase of positive balance of trade in goods.

The growth of exports was positively influenced both by active foreign trade policy on search for new markets and economically favourable trade policy.

The trade balance is of foremost importance for the economic development of Ukraine. It is crucial for stability of hryvna since in the main the very foreign trade defines demand and supply in the money market.

Improvement of foreign trade balance for the first half year of 2003 was due to the balance of services, which increased 1.6 times in comparison to the correspondent period of the previous year. The positive balance of the current account was increased by 25% within the given period [20].

However, the attained positive balance of current account does not settle the problem of external debt servicing. In 1999 Ukraine repaid USD1.9 billion, 2000 – over USD 2.2 billion, in 2001 – over USD 1.1 billion, 2002 – over USD 1 billion. The coefficient of long-term external debt servicing (as the ratio of settlement costs of the principal sum to the exports of goods and services) in the first half of 2003 did not differ much from that of the previous year, which is 12.0 and 12.3% respectively. At present, the long-term external debt of Ukraine makes USD 12.7 billion for the first quarter of 2003. Within the next five years Ukraine will have to assign approximately USD 1.9 – 2.1 billion, including the IMF payments, to external debt servicing and settlement, as compared to USD 1.4 billion in 2002 [18].

Payment of external debts is a precondition to formation of negative balance of capital account and financial operation. Repayment of restructured external debts and settlement of debts to Russia amounting to approximately USD 1.1 billion in 2000, which was stipulated by the agreement on the Black Sea Fleet, caused the deficit of current account amounting to USD 1.3 billion as compared with earlier years, when financial account tended to decline due to funds outflow from Ukraine and negative balance of this account was predisposed to continuous decrease. In the main, these changes were a result of the measures taken by the National Bank of Ukraine on intensification of control over the portfolio investment flows and restructuring of Ukraine's debt to Turkmenistan for natural gas in 1990–1994. Moreover, the deficit of current account decreased because the flow of direct foreign investments amounted to USD 0.7 billion and significant earnings from public bonds allocated in the foreign markets, that is USD 0.8 billion for the first half of, 2003. For the most part, it is due to this fact that the deficit of capital account and financial account for the respective period in 2003 was 4.4 lower than that for the 2002 [20].

The prospects of Ukraine's cooperation with the IMF are worth mentioning as well. The practice of transition economies has showed that for stabilization of economy, especially as far as financing of current account deficit is concerned, many countries employed the IMF loans. On completion of the four-year program of extensive financing in the amount of USD 2.64 billion in September 2002, the government of Ukraine expected to renew the cooperation with the IMF within the framework of a new stand-by program. It is also provided that it will be implemented within 3–5 years while its amount may comprise USD 600–800 million. In this relation, it is compulsory for Ukraine to meet a number of requirements, explicitly – to finish the audit of Naftogaz Oil Company; to improve electric energy rates as agreed with foreign investors investing into the electric power plants; intensification of bank supervision; elaboration of the program on liquidation of VAT reimbursement debts. Meanwhile, Ukraine has been steadily reducing its financial obligations to the IMF by the end of 1999, when the principal sum of the debt reached the record high rate of USD 2.8 billion. However, the sum of Ukraine's indebtedness to the IMF currently makes up USD 1.8 billion. Concurrently, gross monetary reserves reached USD 7 billion. [30].

Certain experience in managing capital flows and their impact on the balance of payments is available for Ukraine. Thus, in early 1997 the impetuous short-term capital formation in Ukraine's market of public state bonds was happening as a result of high profitability of this market. The inflow of capital provoked the interventions by the National Bank of Ukraine with the aim of redemption of overabundant dollar supply in the home market and also activated the balance of payments and had a positive impact on the international working balance rates and dynamics of interest rates.

Soon after, the decrease in balance of payments was observed in the second half of the same year. It was caused by the first surge of monetary crisis which also involved Ukraine in the fall of 1997. The withdrawal of non-residents from the financial markets and the scrip market of Ukraine led to a change in the financial flows, while the outflow of capital from Ukraine forced the National Bank of Ukraine not to purchase foreign currency as it was the case throughout the previous 8 months but to sell it, which had a negative effect on the rate of monetary reserves and the structure of monetary aggregate. The outflow of capital in the form of portfolio investments took place in 2000 and its volumes exceeded USD 200 million [4]. During 2002, the capital previously invested into domestic corporate securities also tended to outflow. The investment business, enabling non-residents to share capital, was accompanied with the outflow of monetary resources in value of USD 1 billion. Such an outflow of capital has caused the complete leveling of proceeds on the account of «Direct investments» in Ukraine, which in 2000–2002 amounted to USD 1.76 billion (making an allowance for privatization in 2001).

In 2003, leading rating agencies raised the credit rating of Ukraine, which is very important for Ukraine. This was conditioned by the increase in gold and currency reserves of the National Bank of Ukraine that is also indicative of the recovery in balance of payments. Thus, in June of the current year the international currency reserves have increased by USD 864.6 million and this is primarily due to the receipts from placement of Euro bonds. The Euro bonds issued in June 2003 conclusively proves that unlike the internal debt obligations, the external obligations are more long-term and cheap: the Euro bonds placed by Ukraine have 10-year period of maturity and the cost of providing service is 7.65% per year [12].

The possibility of governmental loans seems problematic in the national market of capital as a result of undeveloped stock market and low investor demand for corporate securities because of weak value market and slow development of privatization. Thus, according to the results of the auctions held, a twice less budgetary funds was obtained for the first half of 2003 as compared with the respective period in 2002 [5].

Currency reserves can be found among the key factors directly affecting the balance of payments. Within a theoretical perspective, the relation between the rate of currency reserves and balance of payments can be expressed by the following equation: if the balance of payments is in the surplus, then the currency reserves increase, that is $Z > 0 \to R > 0$, and vice versa, under the deficit of balance of payments, the currency reserves diminish: $Z < 0 \to R < 0$ [21].

It is essential that the rate of currency reserves characterizes the credit standing of the country. The index of net nominal currency reserves is widely employed in international currency payments. This index is the criterion of the country's ability to repay debts and emerges as an efficiency factor of the credit and monetary policy of the National Bank of Ukraine. The index of currency reserves adequacy for import payments is based on the net official monetary reserves and expressed by the following formula:

$$V = \frac{R}{Im} \times 12 \text{ months}$$

where V – is the index of currency reserves adequacy;
R – is the net foreign currency reserves;
Im – the gross volume of imports.

A country is customarily regarded as having problems with receiving new credits if the index of currency reserves adequacy for import payments is less than a three-month imports coverage.

Moreover, the increase in currency reserves can be viewed as a positive factor for stabilization policy. Firstly, it leads to increase in currency provision of money basis and correspondingly improves stabilization of monetary system of national currency. Secondly, it extends the possibility of National bank's regulation of exchange rate through interventions when temporary fluctuations in demand and supply occur.

Another indicator characterizing the state of the payment balance and the solvency of the country is the saving–investments balance, i. e. S, -1.

Once savings exceed investments – $S > 1$, then the country can give out external credits, but as soon as a reverse situation takes place – $1 > S$, the investment demand increases in the country (as a result of fiscal policy).

The insufficient savings in the Ukrainian economy can partially be explained by low income level, although the disillusionment of Ukrainian population about the incapability of government to secure real stability of the national economy, currency and banking system seems to be a more important reason. However, the natural persons' savings tend to increase more persistently lately. Throughout past seven months of 2003 they increased by UAH 6.5 billion or by

32.7% in comparison with the respective period of the previous year [6]. It is possible to increase the volumes of national investments due to increase in savings, which would lessen the need for external financing.

Although the coefficient of propensity to save in Ukraine equals to 0.3 (according to Keynes, this coefficient makes up only 0.2), it is customary to consider that savings take place in Ukraine only when income exceeds USD 100. At the same time, it would be appropriate to believe that the potential of private savings in Ukraine is not lower than the volumes of external governmental loans.

Therefore, the increase in currency reserves and savings is obligatory for transition economies, which experience the deficit of payment balance in the period of reformation, in order to achieve macroeconomic stability.

In comparison with other Eastern European countries, the currency reserves of National Bank of Ukraine are still insufficient. In most encouraging year of 1997, the coverage of imports with currency reserves didn't exceed two months. In 1998, the exhaustion of National Bank's reserves was mainly predetermined by the extremely short maturity period of external public debt paid within destabilization and considerable increase in demand for money evoked by the currency crisis in Russia. That's what exactly caused the sheer devaluation of hryvna after the long period of its stabilization.

The decrease in currency reserves produced depreciation of hryvna along with aggravation of debt crisis. As it was expected, the reserve tranche of IMF in August 1998 affected the currency reserves and stabilization of exchange rate. Moreover, the establishment of new currency corridor increased the demand for dollars while the exchange rate was sweepingly devaluated – UAH/USD 2.25 in early September to UAH/USD 3.3 in late September, which made 47% of the dollar rate growth.

The monetary policy held in 2001 by the National Bank of Ukraine stimulated the increase in currency reserves. It was conditioned by objective factors and caused positive outcomes, monetary stability and predictability of situation can be found among them. First of all, the devaluation of hryvna would not be possible if its supply exceeded its demand. Even though the rates of imports increase were rather high, this had its positive impact on the balance of trade and caused the increase in currency reserves.

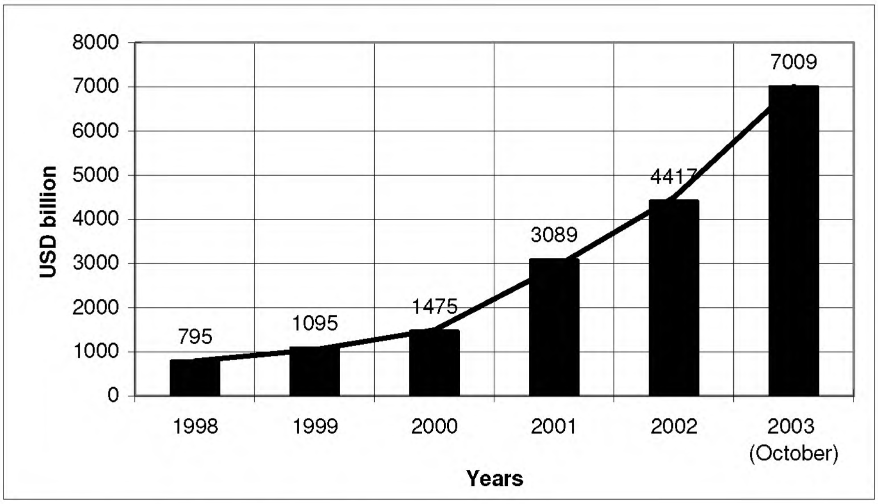
Replenishment of gold and currency reserves in 2000–2002 was also preconditioned by dynamic currency and monetary policy of the National Bank of Ukraine, which managed to equilibrate the amount of demand and supply for currency, to improve real effective exchange rate. Certain macroeconomic factors motivated the increase in currency reserves of the National Bank of Ukraine, including the low-deficit budget, the decrease in external debt, and economic growth and stable high demand for national currency.

At the same time, the increase in the balance of trade and current account resulted in extension of exchange currency inflow, which made currency supply higher than demand. The interventional policy of the National Bank of Ukraine brought about the increase in currency reserves.

It is worth noting that by November 2002 the only source for increase in currency reserves were exceptionally the interventions of the National Bank of Ukraine into the operations with excessive supply in the money market.

Figure 2.

International Reserves of National Bank of Ukraine.
(current exchange rate, billions of USD).



Source: Вісник НБУ. – 2003. – Грудень. – С. 11.

The international currency reserves tended to increase in 2003. It is due to more frequent interventions throughout ten months of 2003 that the amount of gold and currency reserves of the National Bank of Ukraine was increased by the record high value – USD 2.2 billion – and for the first time it exceeded the point of USD 7 billion, which secured the coverage of imports (Figure 2) [30]. High frequency of interventions of the National Bank of Ukraine into the operations with currency was a consequence of excessive currency supply, which was by 39% higher than the demand for the period of 9.5 months as against previous year. In consequence, the increase in demand for this period was based on 11% inflow of currency to the country, which was conditioned by the increase in exports and direct foreign investments and slowdown in outflow of currency and portfolio investments [15].

Despite the increase in payments of external debt in 2003, the new loans totaling about USD 1 billion supported high rates of increase in National Bank's reserves. However, the future payments for its servicing and liquidation will produce a burden for international reserves of National Bank of Ukraine in the future, which can also affect the national balance of payments.

To sum it up, the economic crisis in Ukraine has brought about the excessive deficit of payments balance, which has led to macroeconomic destabilization. Economic growth decreases the deficit of payments balance, though generally due to increase in balance of current accounts. The decrease in deficit of capital account and financial account is problematic as well.

2. Macroeconomic Approaches to Equilibrating the Payments Balance of Ukraine

The instruments of macroeconomic policy are used to equilibrate the payments balance. The macroeconomic policy of transition economies is aimed at economic stability. For all that, the macroeconomic policy does not always result in harmonic combination of external and internal equilibrium and balance of payments, in particular.

Ukraine has chosen the monetary policy as an instrument for attaining economic stability.

It is worth noting that the exchange rate at many transition economies, excluding Hungary, went through the same path at first, it depreciated drastically and then was gradually reinforced. It was determined by low national currency reserves and inefficient implementation of macroeconomic policy. At the same time, the Baltic countries (Lithuania, Estonia) and Bulgaria have introduced the monetary regulation in which the nominal fixation was combined with total repayment of basic money at the expense of international reserves. The introduction of monetary regulation encouraged growth of confidence and reduction of inflation, which in turn decreased nominal and real market interest rates.

The retrospective analysis of the monetary policy shows that the dynamics of exports was least responsive to devaluation of hryvna in 1998–1999, when the devaluation of hryvna was sweeping. More responsive was dynamics of imports, especially in 1999, which secured the positive balance of trade for the first time in the period under study. Yet, the balance turned out to be too expensive for Ukraine – hryvna depreciated 2.7 times. Consequently, the on-budget expenditures for external debt servicing increased and real values of the indices characterizing national economic development (GDP, income per capita, volume of corporate capital, etc) went down. These indices left Ukraine far behind world economies on the «ranking table». The innovative of production was also in decline.

In the years of moderate devaluation – 1996, 1997, and 2000 – the responsiveness of export dynamics turned out to be rather high: 1% of devaluation per 3–4% of export growth. The dynamics of imports was less responsive, while its volumes, notwithstanding the devaluation pressure, were rising. The moderate devaluation turned out to be the most effective: though it stimulated export growth, it carried on import growth.

It is worth to note that a significant potential of devaluation impact upon competitiveness of goods was used inefficiently in terms of trade balance formation. Although in 2000 trade balance was positive, its volume was not adequate to the level of hryvna devaluation.

The lack for direct dependence between exports and imports dynamics in Ukraine and the exchange rate of hryvna can be explained by several reasons.

First of all, the long-term devaluation policy of Ukraine could incite reinforcement of non-price methods of market protection from traditional Ukrainian exports in the partner countries. For instance, Russia was the first to use these methods, specifically – assessment of Ukrainian goods with the VAT in September 1996 and 25%-taxation of the sugar imported from Ukraine, which led to reduction of Ukrainian exports to Russia and affected the trade balance negatively. At the same time, the antidumping investigations of the USA, Canada and other countries and their constant threats came about more frequently. Under such conditions, the potential of price competition provided to the Ukrainian exporters through devaluation policy could merely be exercised.

Second, most of the Ukrainian exporters depend on imports, consuming imported energy resources, raw materials, and components, etc. Therefore, additional devaluation expenses for imports of these enterprises exceeded the terms and volumes of their exports revenues, which worsened their financial situation and destimulated exports growth. Moreover, growing rates (2.7 times) and continuos (over 2 years) depreciation of hryvna motivated steady devaluation expectations of economic agents, which caused spreading expectations of unexaustability of the devaluation resource and did not stimulate the exporters to increase exports.

Inefficient utilization of devaluation earnings derived by the exporters could distort the importance of devaluation for competitiveness and resultantly the dynamics of exports and imports (and trade balance correspondingly). According to O. Shypko, within the period of 1998–1999 alone these earnings made up nearly UAH 40 billion, that is about 40% of GDP in 1998 [23]. As a result, the devaluation potential was wasted.

It is well known that the discussion about the trends of monetary policy in Ukraine became most pressing in 2001, when after continuous stabilization of hryvna versus USD in 2000 and increase in 2001, the world market opportunities were deteriorated for Ukrainian goods and the time for repaying external state debt approached. Three standpoints were delineated in theoretical disputes [8, 24]:

- the representatives of some export business and government supported rapid devaluation;
- the representatives of National Bank of Ukraine and scientists sharing this standpoint supported moderate devaluation;
- the representatives of circles supported mainly the policy of slow revaluation.

The first and the second standpoints do not differ fundamentally – both are of devaluation nature, the difference is in the devaluation rate only. As the earlier practice shows, the devaluation of 1998–1999 was least effective in Ukraine. The competitiveness of the Ukrainian exports must be built on a brand new basis instead of the manipulation with prices.

As a result, the moderate and steady devaluation turned out to be more efficient in previous years and was ensured by the National Bank of Ukraine in the Basic Monetary and Credit Policy of 2002. However, such devaluation as a steady monetary policy can have negative outcomes: it may cause the «hothouse effect» in the exports sector and inflationary anticipations in the country.

A. S. Halchynsky was among the first Ukrainian scientists who identified the outcomes of steady and slow devaluation and presumed that "slow devaluation of exchange rate is more expedient for Ukraine" than the policy of devaluation [7].

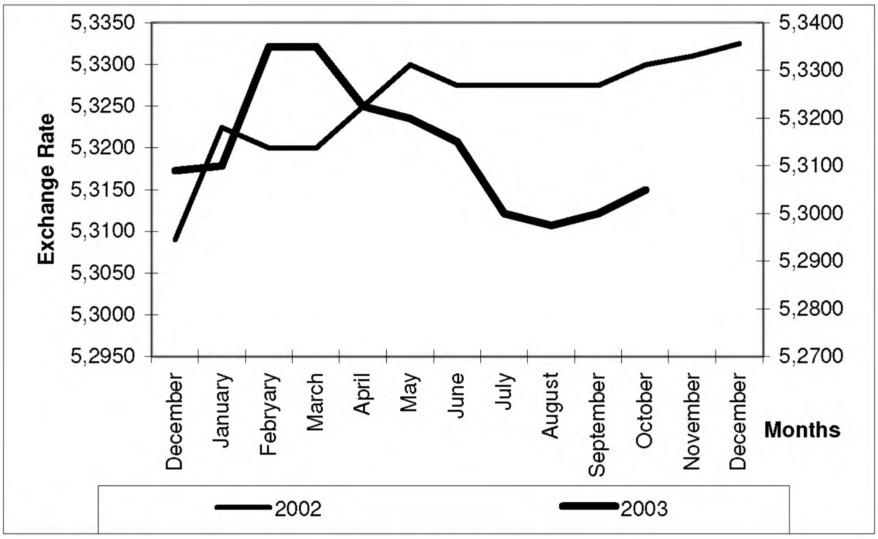
Thus, in order to avoid the negative effects of both devaluation and revaluation, it would be feasible to carry out the long-term policy of stabilization of exchange rate along with periodical deviations in either direction when a certain sector of the economy can be supported just by the instruments of the monetary policy. Under such a policy, devaluation and revaluation can be periodically applied as temporary instruments changing one another without disturbing the tendencies of monetary policy.

Indeed, the National Bank of Ukraine follows the policy of nominal monetary stability of hryvna. The monetary stability implies the dynamics of the exchange rate fluctuating within defined boundaries, without rapid changes or breaking the established guiding lines for the future prospects rather than its absolute stability. In terms of figures, the monetary stability of hryvna in 2002–2003 is expressed by actual devaluation by 2.2% for the four years which makes approximately 0.55% per year [15].

The dynamics of the exchange rate of hryvna to dollar in 2003 was more flexible than it was in 2002 (Figure 3).

Figure 3.

The dynamics of the Exchange Rate of UAH to USD.



Source: Bulletin of National Bank of Ukraine, December 2003 – p 10.

This was evoked by economic conditions and targets of the National Bank of Ukraine concerning the general financial stability and stimulation of production. In 2002, under deflationary dynamics of prices, the National Bank of Ukraine encouraged inessential devaluation which increased the competitive capacity of the goods on external markets, which allowed avoiding the negative impact on prices.

Yet in 2003, the monetary policy was slightly modified. Until March 2003, the National Bank of Ukraine carried out inessential devaluation to support exports, whereas starting March of the same year, the National Bank of Ukraine supported steady revaluation of hryvna in order to stabilize the prices.

Thus, rather flexible monetary policy carried out by the national Bank of Ukraine in 2003 was aimed at supporting the stability of national currency along with keeping positive balance of trade and current account.

Likewise, similar to other transition economies, the expansionary monetary policy in Ukraine can be found among the instruments for acceleration of transition to steady economic growth and the factor affecting the balance of payments.

First positive changes in the monetary policy can be observed in 2002. The monetary policy of the National Bank of Ukraine was intended to increase money supply. Saturation of the economy with money was conducted in all possible ways: through money-market, reduction of interest rates, refinancing of commercial banks, operations with securities in secondary markets. Moreover, the volumes of currency purchases increased as a result of increase in earnings from exports, and its rates keep on rising. According to the statistics of the State Statistics Committee, the exports of goods in the first quarter raised by 27.9% while the positive balance of foreign trade of Ukraine increased to USD 1114 billion (from USD 964 billion in the respective period of previous year).

The increased turnover took place adequately to the needs of the economy. For the year of 2002 the volumes of the money supply increased by 28.8%, the monetary basis – by 26.1%. The positive balance of current account exceeded that of the previous year almost in 1.75 times.

Taking into consideration the balance of income and payments balance, it would be feasible to increase money supply according to GDP growth. The monetarisation of currency reserves should still remain as the instrument of increase in money supply, which emphasizes the importance of the positive balance of current account when the balance of current account is negative.

Even though money supply plays an important role in determining the dynamics of both the real exchange rate, revenue and trade balance directly, the economy in transition is characterised by considerable dependence of monetary policy on fiscal indices. The compliance and consistency of monetary and fiscal policy gain in importance in the strategy of post-crisis development of national economy [14]. So far, the Ukrainian economy lacks appropriate level of coordination between the monetary and fiscal policy. It was typical to combine a trenchant monetary policy with its definite anti-inflation orientation and a comparatively liberal fiscal policy oriented towards accomplishment of social needs of the society. It is crucial to employ the stimulating effect of implementation of monetary and fiscal policy with the purpose of dynamic and long-term development of national production.

In 2002, the macroeconomic stability and development of economy allowed the National Bank to carry on the policy of cheap money. Due to the lack of inflation, the National Bank of Ukraine managed reduce the interest rate and lower the banks' required reserves. Throughout the year, the rate was reduced from 12.5% to 7%. Moreover, the standard of reservation covering short-term monetary funds and deposits in national currency was reduced to 2% for natural persons and 6% for juridical persons.

Despite the attempts of the National Bank of Ukraine to carry out the weighted monetary policy, the board of management of the National Bank of Ukraine had to compromise and finance the budget deficit through taking out the bonds of internally held government loans, effecting the quasi-budget operations, supporting of banks declared as financial bankrupts, servicing the external debt etc. Hence, the problems with the monetary policy emerged as inclination of the currency exchange rate towards speculative attacks and negative impact on the balance of payments.

The implementation of inflation targeting is an imperative for Ukraine as well, which is supposed to accelerate Ukraine's transition to steady economic growth. Thus, implementation of inflation targeting in transition economies, Poland and Czech Republic in particular, was intended to harmonize the development of external and internal sectors of economy, stabilize expectations of economic entities, and increase long-term investments due to reduction of interest rates. As N. Dorofeyeva and A. Tsokol put it, the Ukraine's economy, its monetary and financial system are not prepared for the inflation targeting [10].

The monetary system will experience another problem of transition from the policy of «permanent» currency exchange rate to the regulated one with fluctuations, which would represent changes in fundamental macroeconomic equilibrium.

At the same time, it is worth noting that currently Ukraine under-employs the potential of its own market by preferring exports, which have made 69.5% of GDP already in the first half of 2003, having therefore a tendency to grow. The stimulation of exports, as the above analysis persuasively shows, is normally executed through devaluation that «artificially» increases the competitive capacity of the Ukrainian goods in the foreign markets. This undoubtedly affected the balance of trade which was predisposed to growth in recent years. Consequently, in order to attain the positive balance of payments in Ukraine since 2000, the balance of current account was increased while the balance of capital and financial accounts remains negative.

The monetary and credit policy in 2003 was carried out according to general macroeconomic development and was oriented towards internal and external stability of national currency. For the period of eight months the monetary basis increased by 24.1% to UAH 38.2 billion, money supply – by 28.7% to UAH 83 billion [17]. Such a dynamic increase of monetary aggregates is adequate to current economic development and aimed at supporting economic growth and remonetarization of economy.

The necessity to support the stability of nominal currency exchange rate predetermined by positive balance of current account can be found among the factors allowed for by the monetary and credit policy, which preconditions substantial extension of money supply in the internal market. Investments in the money market in eight months of 2003 made USD2.2 billion (while in previous year they amounted to USD1.4 billion) and for the most part were a factor of general increase in money supply. Money demand was satisfied through increase of money basis on account of operations in the money market and increase in banks refinancing as well as by way of multiplication of money.

It is worth noting that in 2003 the long-term credits tended to increase and their share in the overall turnover for the eight month of 2003 increased up to 36% (in 2002, respectively – 22.3%)

The increase in the share of long-term credits, which are needed for Ukraine to modernize and update the industrial production, will expectedly affect the rates of economic growth in positive way that will have its impact on the balance of trade first of all. The effected in 2003 monetary and credit policy also allowed for the last year's inflation, which caused the inevitability to revive the price dynamics as a stimulus for economic development.

Important is the fact that the reliance on national currency grew, which diminished the significance of foreign currency as a means for payments and accumulation outside the banking sphere. For the eight months of 2003 the cash supply exceeded its demand four times in comparison with the correspondent period of the previous year. The major principles of monetary and credit policy for 2004 implied that the strategic purpose would be the support of hryvna stability as a monetary precondition for gradual transition from extensive economic growth to development based on innovation and investments and attainment of long-term social, structural, and institutional purposes.

In order to achieve this purpose, it is necessary to extend the targeting of monetary unit stability, which involves constant monitoring of price dynamics of goods and services, currency exchange rate and interest rates, their correlation and, if necessary – manipulation, by the instruments of monetary and credit policy. At the same time, the foundation for gradual transition to inflationary targeting will be created [9:19].

Consequently, monetary and credit policy is aimed at supporting stability of domestic prices, dynamics of real effective exchange rate of hryvna and rates of money supply growth within the limits, that would secure the achievement of the main goal – economic stability.

3. Trends in Macroeconomic Policy and Specific Features of Payments Balance Equilibration in Transition Economies

At the beginning of reformation, Eastern and Central Europe experienced the economic crisis which involved almost all transition economies and provoked substantial deficit of the balance of payments. Therefore, equilibration of the payments one of the major problems of the countries transiting to macroeconomic stability and economic growth in the future. Reduction of the balance of payments in, for instance, Ukraine and Russia is effected though increase in balance of current account, while in such countries as Poland and Hungary – through increase in balance of capital and financial accounts.

In accordance with the studies by V. Shevchuk, the balance of trade tended to decease in the Eastern European economies, which however did not impede economic growth [22].

The Czech Republic is the Eastern European country which successfully overcame the transition period. It is in the second half of 1991 that the Czech Republic has reached economic stabilization while in 1992 it has overpassed the transition stage. By introducing fixed exchange rate of the national currency, the Czech Republic expected to import low inflation from the main partner, Germany.

As a result of three successive devaluations of czk, when the exchange rate went through nearly the 100% drop, the exchange rate of 29 crones for one USD was finally established, which has remained such for 13 years already.

It is also worth noting that at the beginning of transition period in 1991 the positive balance of current account was established, but in 1994–1995 the imbalance occurred (3% GDP). The conversion of crone was finished in 1995, which stimulated the increase of capital formation. Thus, in 1993 the formation of foreign capital as portfolio investments made 10% of GDP, in 1994 – 12%, 1995 – 18%. Due to portfolio investments, the deficit of the balance of current account was partially financed. However, as O. Bakun points out, the Czech economy did not need foreign capital [3]. As the central bank purchased the currency which circulated in the country, money supply increased. The measures taken by the National Bank of Czech Republic to sterilize capital flows were not always efficient. At that, the deficit of state budget increased and the ratio of bad credits enlarged. Starting 1997, crediting was nearly suspended. In 1997, the National Bank of Czech Republic renounced the fixed rate and switched over to inflation targeting. Under these conditions, the Czech practice of inflation targeting has demonstrated the efficiency of the implemented macroeconomic policy.

It is due to effective macroeconomic policy that the Czech Republic has overcome the economic crisis, and starting 2000, a stable economic growth has begun.

In general, during the period of economic growth, typical was the surplus of the payments balance, although some individual accounts were in deficit as well. Thus, in the first half of 2003, the deficit of current account made czk 44.4 billion, while the positive balance of financial account increased by czk 25.9 billion mostly due to the inflow of foreign investments [29]. As estimated by the National Bank of Czech Republic, the surplus of financial account amounted to nearly 8% of GDP. At the same time, the outflow of investments increased as a result of continuous interest in foreign securities.

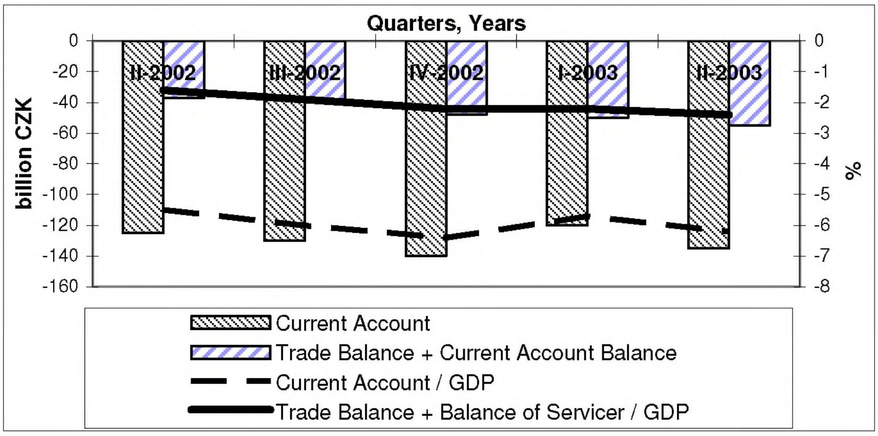
The deficit of trade balance for this period amounted to czk 13.4 billion, whish was the consequence of import growth exceeding export growth (physical rate of exports increased up to 6.6%, imports– up to 7.7%).

The EU countries share 70% of foreign trade of the Czech Republic. At the same time, the trade balance with the other developed countries of market economy (Norway, Switzerland, Japan) is in deficit (Figure 5).

As far as the trade with transition economies is concerned (Slovenia, Hungary), the positive trade balance tended to increase.

Figure 4.

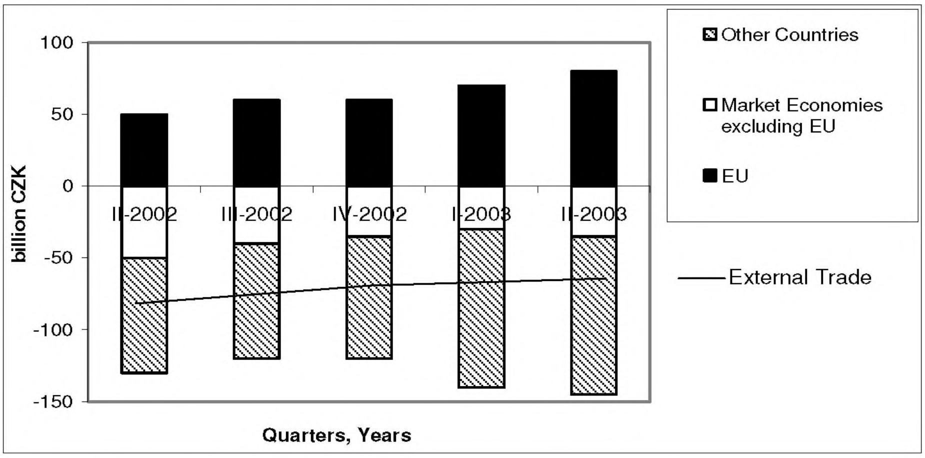
Dynamics of Balance of the Current Account in the Czech Republic, 2002–2003



Source: The Balance of Payment of the Czech Republic in 2003 Q2. – http://www.cnb.cz.

Figure 5.

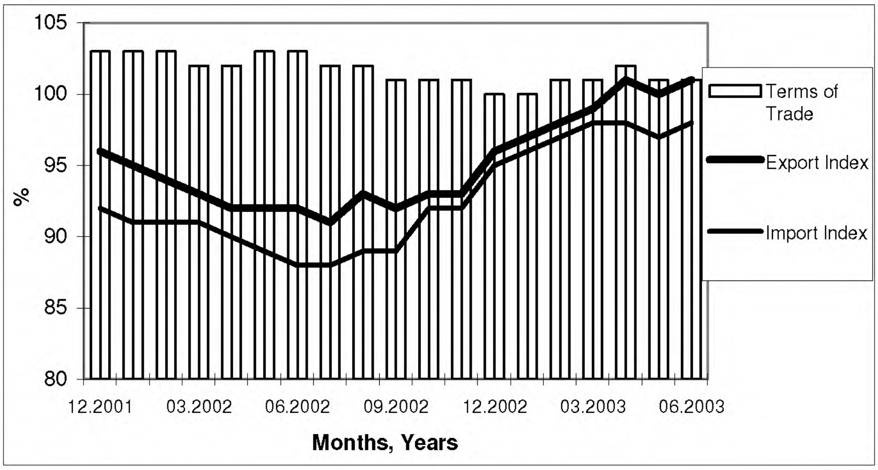
Geographical Structure of Trade Balance



Source: http://www.cnb.cz.

Figure 6.

Trade in the Czech Republic, 2002–2003



Note: the correspondent period of the previous year = 100, monthly data.

Source: http://www.cnb.cz.

The slight improvement in trade (by 1.3%) in the second half of 2003 was motivated by the increase in export prices under practically unchanged import prices (Figure 6).

The monetary policy of the Czech Republic was oriented at supporting the stability of national currency, reduction of inflation, and stimulated liberalization of market and attraction of foreign capital.

Unlike the economies of the Czech Republic and Poland, the economy of Hungary was experiencing an extensive inflation in 1987 as a result of liberalization problems, specifically – in 1987–1988. In terms of consumer price index, the inflation made 15% and 30% respectively. At the same time, the public budget deficit was still too large, in particular, the deficit of current account made 9% of GDP [28].

In 1995, the government of Hungary adopted the program of stabilization of macroeconomy in order to reduce inflation, which came to rapid reduction of state expenditures and gradual rise of tax rates. As a result of given macroeconomic policy, the budget deficit decreased from 9.6% of GDP in 1994 to 7.3% in 1995 and 4.6% in 1996.

In 2000, Hungary was the only European country which succeeded to slow down the rates of inflation as compared with 1999. Moreover, in 2000 the GDP came to over 5%, the unemployment was considerably reduced, and for the first time, the exports reached EUR 30 billion and debt servicing was decreased.

At the same time, foreign economists estimate the prospects of Hungarian economy more critically. Proceeding from the excessive dependence of the Hungarian exports on the market, the experts of The Economist, a well-known London analytical center anticipated a substantial slowdown of economic growth rates in Hungary in 2003 up to 4.0%, taking into consideration the economic downturn in the Euro region. In case the demand for the Hungarian products declines on the part of the European Union and other developed countries, it may lead to a number of unwanted outcomes for the economy.

When analyzing the dynamics of balance of current account, it is worth noting that even in the period of economic growth Hungary experiences the deficit of this account. Starting from the first half of 2000 its deficit has gradually risen and it is from the end of the same year till the second half of 2001 that it tended to decrease (Figure 7). Reduction of the balance deficit (adjusted for seasonality) could be observed in August and November 2001, which has intensified during the next few years. Thus, in August 2003 the deficit of balance came to EUR 402 billion, and it was financed by foreign investments amounting to 172 billion. The deterioration of the balance was caused by the increased deficit of trade balance and the decreased income from securities and transfers.

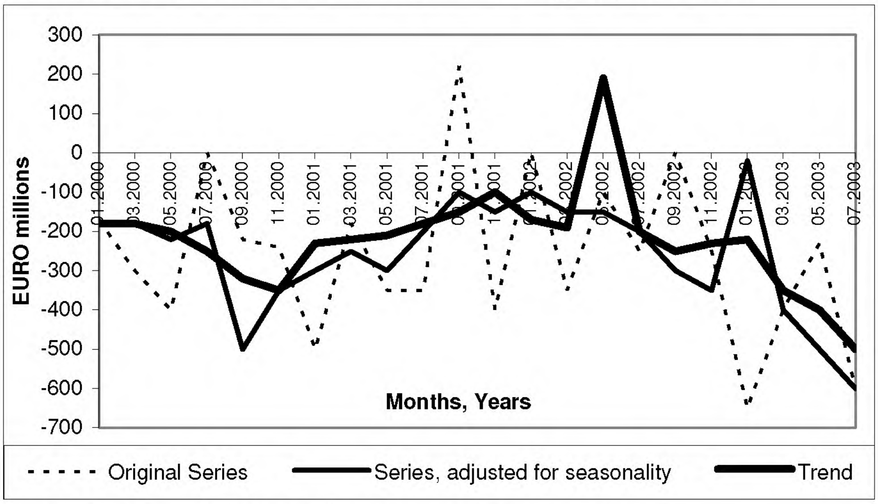
As it can be seen on the Figure 7, the trend of the trade balance is practically the same as that of the current account. The deficit of the balance of foreign trade made up EUR 347 billion (exports – EUR 2709 billion, imports – EUR 3056 billion), which was higher than in the previous year and was preconditioned by rapid import growth rates [27].

What concerns the balance of services, it tended to increase starting from 2000 until October 2001, and later on – to decrease. In August 2003 the balance of services made EUR 40 billion, which was three times less compared with the correspondent month in 2002. This can be explained by the decrease in income from portfolio investments and tourism services.

The payments balance and the rate of exchange reserves in Hungary were positively affected by net inflow of capital. By the end of August 2003, the exchange reserves of the Central Bank of the Czech Republic in foreign currency amounted to EUR 10.7 billion. The inflow of net capital into Hungary through external and internal operations in 2003 made EUR 173 million, direct investments by Hungarian residents abroad made EUR 12 million, non-residents' investments in Hungary – EUR 120 million [28]. This induced the positive balance of payments to grow.

Figure 7.

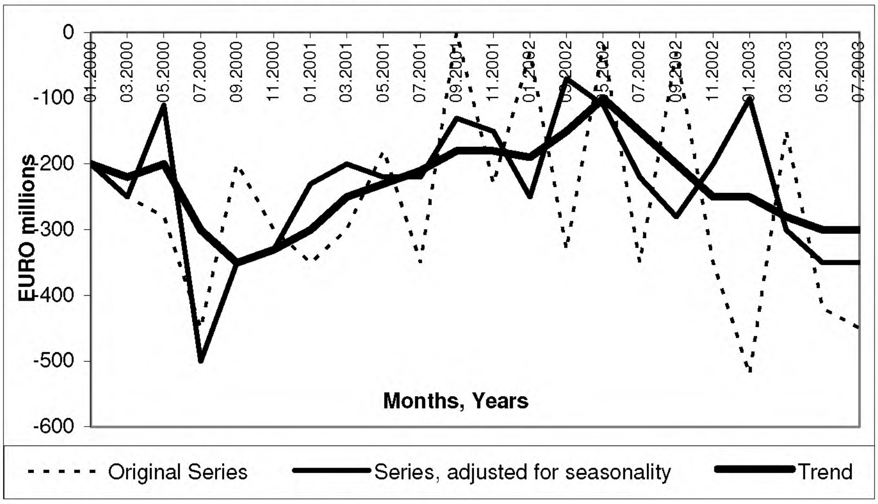
The Balance of the Current Accounts in Hungary, 2000–2003



Source: Pre-accession economic programe of Hungary 2003.
www.p-m.ru/documentumok/English/Pep-angol.pdf

Figure 8.

The Balance of Foreign Trade in Hungary, 2000–2003



Source: Balance of payments of Hungary.
www.english.mnb.ru/dokumentumok/fmo3q1_en.pdf.

As for monetary policy, it would be worth noting that in the early 1990's, the exchange rate was adjusted with periodical devaluations. In the fist half of 1995 the country transited to flexible exchange rate, to be exact – the "crawling" devaluation, which was conjugated with the decline in payments balance and the necessity to increase price competitiveness of the Hungarian goods. Stabilization of real exchange rate and increase of trade balance took place in 1997, which yet again proved devaluation to be not the only instrument for exports stimulation. In this case, exports increase was aroused by ever-increasing demand for Hungarian goods.

Hungary will have to meet the requirements on inflation rate, deficit of payments balance and currency exchange rate fluctuations in order to be able to enter the European Area. Hungary is expected to enter the European Union in May 2004 while the Euro currency is likely to be introduced in January 2008. The advantages of common currency may have the effect in two contexts: on the one hand, the introduction of the Euro will stimulate macroeconomic stability, reduction of risks and «implementation» of steady economic policy, and on the other, it will create a favourable background for rapid economic growth.

Introduction of the Euro in Hungary will allow to reduce both the currency risks and real interest rates, diminishing therefore the transaction costs. Along with that, the investment capabilities of the country will enlarge, which will positively affect the economic development of Hungary. As a result of introduction of common currency, the trade will expand, which will lead to intensification of competition, which, in turn, will stimulate enhancement of productivity (the demand and supply will rise).

The advantages of the Euro introduction will definitely not be self-materializing. It is necessary to carry out the correspondent economic policy: adjustment of monetary policy to reduced interest rates; well-maintained financial control. As the Hungarian government believes, the benefits of the Euro implementation will exceed any expenses that may occur as a result of potential risks.

Within the next few years, the monetary and credit policy in Hungary will be oriented to reduction of inflation, stabilization of prices which will secure macroeconomic stability in the country.

Poland, one of the most successful countries among the Central European states, experienced rapid economic growth in the transition period. In 1999, its GDP was by a quarter higher than in was at the beginning of reform in 1989 (the highest rate in the region). Followed by the reduction of 15% in 1990–1991, the annual economic growth made 5%. The start of economic growth in Hungary has delayed almost 5 years up to 1997.

Like most countries of Eastern Europe, at the beginning of the transition period Poland had positive balance of current account. In the course of time, the balance of current account tended to be decreased, its deficit in 1999 came to 7.6%, which was caused by macroeconomic imbalances in the Polish economy.

The deficit of current account (nearly 46%) in 1999 was financed through direct foreign investments.

In 2002, the deficit of current account made EUR 7188 million, which shows the decrease in the index by 10.1% as compared with 2001. The reduction of the deficit of current account was excited by improvement of the trade balance. It is worth noting that Germany was one of the major partners throughout 10 years. An extensive recession in trade could be observed in Russia and the USA. Restrained privatization processes called forth the decrease in direct portfolio investments by 45% as compared with the previous year. As a result, the importance of direct foreign investments in financing of deficit of current account reduced by 97.8% (in 2001 – by 60.3%). The balance of current capital account and financial account was significantly increased – approximately 2.2 as high in comparison with the previous year – EUR 6027 million. This was incited by the increase in portfolio investments in Poland by EUR 2023 million as compared with the previous year [32].

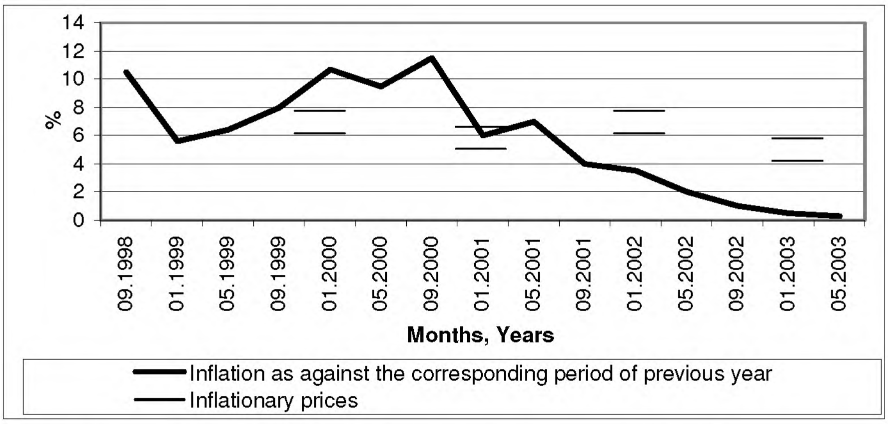
The monetary policy was of great significance for macroeconomic stability and reduction of deficit of the payments balance in the period of reforms. Poland was the first to decline the system of multiple exchange rates. The transition to floating exchange rate was to a certain extent related to the problem of payments balance equilibration. Binding Polish zloty to USD in January 1990 was considered as an instrument of anti-inflation “anchoring” in hyper-inflationary environment created by monetary shocks and rapid liberalization of prices. In order to secure price competitiveness of exported goods, binding the monetary unit was based on the undervalued rate (devaluation of zloty to the exchange rate of «black market» amounted to 31%). This left much space for inflation adjustment of prices. It is worth noting that the Polish model of the transition period was founded on such elements as rapid liberalization of prices (during 1989, the share of free prices grew from 25% to 90%), the conversion capability of the current account and almost total liberalization of the foreign trade (January 1990).

Restrictive fiscal and monetary policy within this period enabled to support the fixed exchange rate of zloty for the duration of 18 months. In May 1991 the fixed exchange rate to USD was replaced with binding to the currency basket, which was meant to improve the structure of foreign trade of Poland. Concurrently, the exchange rate was devaluated by 14%. At the beginning of transition period, Poland has much indebtedness, despite 50% of external debt being written off in the early 1990’s.

In the second half of 1991 an immense inflationary inertia preconditioned the “crawling” devaluation of Polish zloty with respect to the chosen «basket» of currencies. Within 1995–1999 the gradual slowdown of the “crawling” devaluation could be observed, while in the first half of 2000 the transition to the floating exchange rate was effected. Starting from 1998, implementation of the inflation targeting in Poland gradually resulted in decrease of inflation. For the period of 2001 till first half of 2003, the inflation rate was noticeably lower than the target indices, and the economic growth was approximating zero (Figure 9).

Figure 9.

Inflation in Poland in 1998–2003.



Source: Bulletin of National Bank of Ukraine – December, 2003 – p 10.

The empirical study [25: 26] maintains that implementation of inflation targeting in transition economies at the early stages is caused by the drop off in the rate of GDP growth, though in the course of time, the economic growth will be normalized.

Consequently, the period of inflation targeting in Poland is a period of adaptation which is accompanied by inevitable losses in the real economy.

Regarding the policy of exchange rate, it is worth noting that throughout the two-year employment of the exchange rate mechanism (ERM-2) zloty was allowed to deviate within the standard parity (±15). The establishment of high rate of zloty (PLN) to Euro (EUR) was one of the requirements of the Polish government.

Considering the real exchange rate of zloty, the expected rate of USD/EUR and other factors, the National Bank of Poland anticipates the high rate of PLN to Euro and its stability in 2004–2005.

The utmost task for the credit and monetary policy in the nearest future is stabilization of inflation on the low level and preparation of Poland for entering the European currency area. Given that in 2003 the credit and monetary policy was based on transition from deflation to the stage of inflation stabilization (1999–2003) provided for 3% ± 1 of inflation rate and less than 4% by the end of the year, it was planned for the year 2004 to reach the decrease in inflation rates by 2,5% ± 1 [32]. Another essential requirement for entering the European Union is to settle the interest rates between Poland and the EU states. This will allow decreasing the risks of Poland's entering into the Euro area. In the following years, the monetary and credit policy will be based on the direct investment strategy which entails implementation of floating exchange rate.

The economic policy of Russia at the beginning of transition period was aimed at macroeconomic stability and decrease of payments balance deficit. Thus, within the period of financial crisis (1998–1999), the payment balance was inclined to considerable decline and the balance of gold and currency reserves was predisposed to decrease. In 2000, the policy of the Russian government aimed at increase of currency and gold reserves permitted to increase their volume by the end of 2001 up to USD 39 billion, while by 2002 – up to USD 47.8 billion [2]. By mid- 2003, the currency and gold reserves of Russia have reached their maximal value of USD65 billion as a result of rubble reinforcement and active currency purchases by the Central bank, while the coefficient of international reserves adequacy in the second quarter of this year made up more than 6 months (by the end of 1993 this coefficient was 1.4 months) [31]. For comparison: the same coefficient in 1993 for Taiwan was 13.7 months, Chile – 11.9 months, Spain – 6.1 months, Switzerland – 6.0 months, Japan – 4.9 months. It is worth noting that the principal share of Russia's currency and gold reserves falls at the foreign currency. In 2003 the quarter of reserves was formed in Euro.

In the face of certain economic and political difficulties in the CIS countries, the economic relations with Russia remain to be relatively stable. On the overall, the payments balance in payment transactions between Russia and Ukraine tend to be positive, and the gap between exports and imports has a propensity to diminish, although it was large before. Within the last two years the rates of import growth from Ukraine to Russia surpassed the rates of exports growth, while the positive balance of the current account was likely to diminish.

Considering this problem, it is worth noting that Russia is «rescued» by the essential positive balance of foreign trade balance including that with the CIS countries, which relatively stabilizes national problems. At the same time, the high positive payments and trade balance (100% of GDP) in 2002 produced considerable outflow of capital from Russia [1]. The paradoxical situation emerged: despite the deficit of investments, the country allotted credits abroad.

As is well known, the balance of capital and financial accounts is affected by the outflow of capital. The well-known Russian economist P. Kadochnikov in his studies establishes direct relationship between the balance of capital and financial accounts and the external debt payments [13]. Thus, the external debt payments of Russia for the period of 1999 – first half of 2002 preconditioned the negative balance of capital and financial accounts which partially covered the positive trade balance (Figure 10).

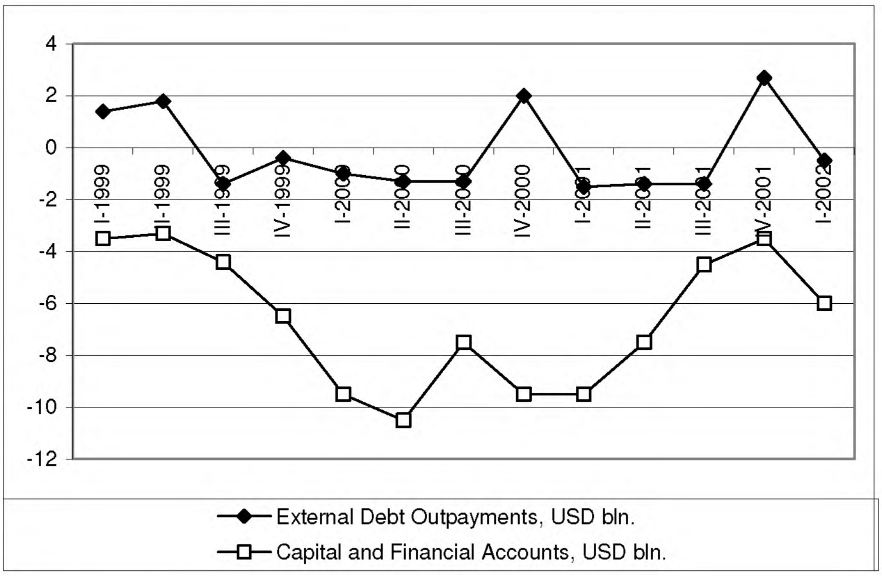
As shown on Figure 10, in general, the fluctuations of external debt payments are similar to those of the payments balance of capital account.

As for the cooperation of Russia with the IMF, it is worth mentioning that this country, which was used to be the major debtor, was not credited by this international organization for several years. Moreover, a number of countries such as Bulgaria, Turkey, Brasilia, and Indonesia suspended their cooperation with the IMF. As a matter of fact, these countries, which used to be traditional debtors of the IMF, have obtained alternative sources of credit funds in the world market. According to the JP Morgan Bank's data, starting from the first half of 2002, the investments of private investors into debt instruments (securities) of developing countries increasingly grew and exceed USD10 billion.

Following the financial crisis, the economic growth in the country was to a great extent encouraged by the monetary and credit policy. It is due to active monetary and credit policy of the Central Bank of the Russian Federation that the extension of operations with governmental securities supply was reduced by the beginning of June 2003, even with the increase in gold and currency reserves. Therefore, it was possible to support the decrease in inflation, which in the first half of 2003 did not exceed 7.5–7.6%.

Figure 10.

Dynamics of Payments Balance of Capital and Financial Accounts, Russian Federation; Net External Debt, Russian Federation
(interest payments excluded).



Source: Community and the Economy – 2003. – № 2. – p. 79.

Furthermore, one more exogenous factor, which affects the monetary and credit policy in Russia, is the dynamics of the world oil prices. The rise in oil prices inevitably leads to increase in exports, which in mainly involve the mineral. Hence, the increase of exports in the period of high oil prices (2000 – first half of 2002) resulted in intensification of currency inflows and accordingly – to the increase of foreign currency in the money market.

The new orientation of the credit policy in Russia was of the special impact on the increase of trade balance, and exports growth of highly processed products in particular. This is due to impossibility to realize exports of machine-building produce, in particular, without postponing dates of payments, or to be exact, credits now. Such credits are likely to promote national products in the foreign markets under aggravated competition. Despite its external indebtedness, Russia grants credits to develop cooperation with a number of foreign countries including its debtors. Incidentally, the major debtors of Russia in 2003 were China (sharing 52% of the total credits), Vietnam (23%) and Yugoslavia (8%). Such a system of credit extension leads to increase of exports in the debtor's country. The balance of current account was positive as well – USD 21.3 billion (as compared to USD 14.6 billion in 2002). On the whole, for the first half of 2003, the exports grew by 29%, imports – by 23% as compared with the respective period of the previous year, which stimulated growth of foreign trade by 7%.

This had its positive impact on the trade balance, as its growth rate was impressive – 37%, while the amount reached USD 8.6 billion. The balance of the current account was positive as well – USD 21.3 billion (as compared with USD 14.6 billion in 2002). A remarkable reduction of the negative balance of financial account up to USD 1 billion, excluding the operations related to writing off the debt, demonstrates the expansion of the investment interest to the Russian economy. The inflow of foreign capital in the country also increased: the external debt instruments grew by USD 5.7 billion. The phenomenon seems even more remarkable if to consider the fact that in 2003 the outflow of capital related to servicing of the «peak» schedule of the external public debt payments.

Subsequent to the financial crisis in August 1998, the real exchange rate of rubble tended to reinforce (Figure 11).

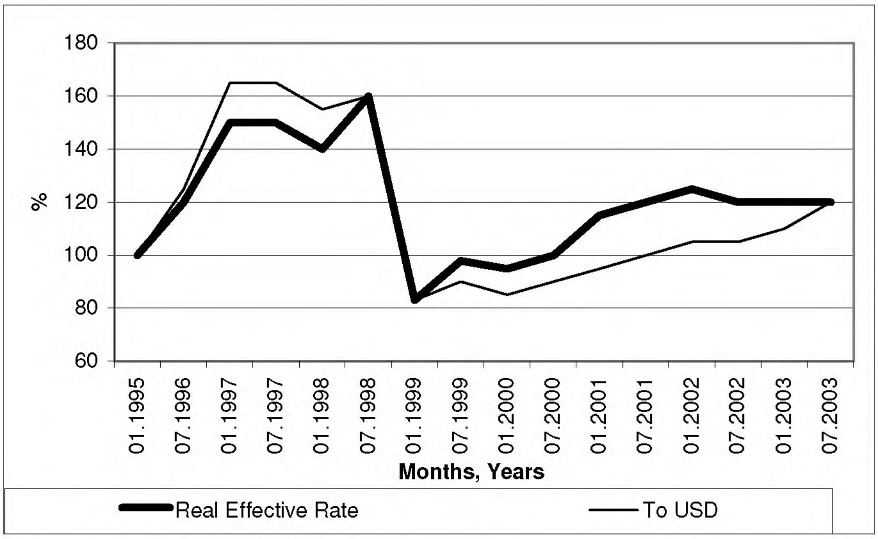
In the first half of 2003, the real reinforcement of the exchange rate of rubble to dollar made up 1.3%, the real effective rate of rubble was reinforced normally by 1.5%. It is worth mentioning that the negative impact of rubble strengthening on the competitive capacity of the Russian goods weakens a bit due to favourable dynamics with regard to Euro – the real decrease of rubble to Euro for the six months of 2003 made up 3.1% (with about a third of Russian imports shared by the Euro area).

Besides, there are various viewpoints regarding the trends of rubble fluctuations. The adherents of the poor rubble motivate their standpoint by lesser protection of national manufactures in front of the foreign competitors. The supporters of the strong rubble contend that the protection from competition is impeded by structural reformations. It is also maintained that the possibilities of monetary control are restricted in terms of real currency rate control. To a great extent this is attributable to the dependence of the real exchange rate of rubble on internal and external factors. The high price opportunities of the exported Russian goods objectively urge the rubble upwards, to be precise, to devaluation. Indeed, for the period from September 1998 till December 2002 the rubble raised by 53.65 in comparative terms. This is due to the encouraging price opportunities of oil and gas exports for Russia. It was only in 2002 under the same stimulating conditions that the exchange rate of rubble decreased by 5.6%. This gave the occasion to talk about the growth of the real exchange rate of rubble in Russia. As indicated by O. Orlov, this was rather owing to strengthening of Euro to USD than the achievements of government and the Central Bank [16].

Therefore, the macroeconomic policy of the Czech Republic, Hungary and Poland is oriented towards steady economic growth and preparation for entering the European Union. The inflow of capital in these countries is the main factor of the payments balance surplus. The positive transformations in the economy of Russia are likely to stabilize the situation in the country, yet do not settle the problem of payments balance equilibration under its high positive balance.

Figure 11.

Dynamics of Average Monthly Real Exchange Rate of Rubble
(January 1995 = 100%).



Source: http://fg.ru/2003/10/21/balans-doc.html.

Conclusions

The macroeconomic stability can be found among the utmost social and economic factors, which precondition stable economic growth.

It is due to efficient macroeconomic policy that the economic growth can be reached in the transition economies. The main target of the macroeconomic policy is stabilization of the economy and convergence for joining the European Union.

The problem of payments balance equilibration gains on primary importance for Ukraine, which experienced its deficit at the beginning of the transition period. In order to attain economic stability, Ukraine has chosen the monetary policy, which in next years is meant to support the stability of national currency under positive balance of currency account, as a main instrument for macroeconomic policy. Allowing for the economic state of the country, devaluation and revaluation can be employed as temporary measures, which periodically substitute each other without breaking the tendencies of the monetary policy.

The support of national monetary unit's stability, furtherance of its credibility, development of economic monetization with the immediate control over the monetary factor's impact on the inflationary processes, stimulation of economic growth are of priority significance for the monetary and credit policy.

In recent years, the economic policy of Russia succeeded in reduction of external indebtedness, relatively high level of currency reserves, stability of national currency, and positive balance of payments. However, the surplus of payments balance is formed by current account.

The Czech Republic, Hungary and Poland have implemented the program of macroeconomic stability and achieved progress in stabilization and liberalization of their economies, while the key instrument of this program was the monetary policy. Implementation of inflation targeting in Czech Republic and Poland was meant to stabilize inflation, harmonize development of the internal and external sectors of the economy, and reduce long-term credits. The Czech Republic succeeded in this relation most of all, as it demonstrated the effectiveness of the macroeconomic policy. At the same time, the period of inflation targeting in Poland is the period of adaptation, which is accompanied by inevitable losses in the real economy. As for Ukraine, the economy and monetary system are not ready to execute such a critical step.

Considering that Ukraine gradually reduces its liabilities to the IMF and has a rather high level of gold and monetary reserves, which exceed USD7 billion, the real possibility to refresh cooperation with this international financial organization is likely to occur. As the practice of Central and Eastern European countries shows, financing of the payments balance deficit in the transition period is partly effected by credits granted by international financial organizations.

On the other hand, the development of the stock market will make it possible to increase the external debts.

The increase of foreign investment in Ukraine will enable to decrease the deficit of the balance of capital and financial accounts. The experience of the Czech Republic, Poland, and Hungary persuasively proves it. Positive transformations in Ukraine on decreasing the deficit of financial account were marked in the fist half of 2003 due to increase of direct investments and substantial income from allocating public bonds in the foreign markets.

Therefore, harmonious combination of objectives for achievement of internal and external stability in transition economies can be considered as a criterion for its economic growth.

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