



Financial and Banking Services Market

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**THE PROBLEMS OF MONETARY POLICY
REALIZATION UNDER
CONDITIONS OF TRANSFORMATIONAL
CHANGES IN THE UKRAINIAN ECONOMY**

Abstract

The article scrutinizes the main problems and peculiarities of the monetary policy realization at different stages of Ukraine's economic transformation. The author delineates the stages of monetary policy realized by the National Bank of Ukraine depending on the macro-economic tasks and strategic missions of the state economic policy under economic transformation.

Key words:

Balance of payments, currency, exchange rate, exchange restrictions, liberalization, monetary policy.

Effective organization of full-fledged monetary relations in Ukraine is determined by conditions of their regulation, which is an objective process of national economy's integration into the world financial system and into the interna-

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tional economy. One of the keystones of this process is the elaboration and realization of the state's monetary policy, which embraces all instruments of influence upon monetary relations and is one of the most important elements in the general system of measures directed at maintaining the macro-economic and financial stability and stimulating economic growth. The importance of monetary policy realization, as one of the key directions of state regulatory influence on the economy, is brought up in the works of prominent national [2, 4, 6, 7, 9] and foreign [5, 8] scientists. Nevertheless, insufficient attention in the existing studies is paid to the analysis of distinctive features and problems of monetary regulation under the unstable conditions of the transformation period, with its peculiar influence of the institutional changes that impact the economic system in general and the organization of monetary relations between market participants in particular.

The given conditions identify the urgency of exploring the problem of Ukrainian monetary policy realization, which is inseparably connected with the processes of building and forming our independent state and reflects the sequence of the changes that determined the market transformation of the national economy and refusal from command methods of administration of economy, including monetary relations. The role and meaning of effective realization of the monetary policy under conditions of transformational changes in the Ukrainian economy is especially important. The monetary policy, as one of the main forms of foreign-economic activity regulation, takes on special significance in practical realization of the state's influence upon all economic processes with the purpose of realizing the strategy of economic development and building the effective market mechanism in Ukraine.

The absence of integral conceptual approaches to the essence and content of the monetary policy realization [1, 3, 10, 11] in domestic economic literature does not contribute to adequate assessment of the processes that took place in the monetary sphere of Ukrainian economic relations during the whole transformation period, as well as organization of the activities of regulatory authorities, primarily the National Bank of Ukraine (NBU), regarding their effective influence upon these relations. Thus, unclear remains the idea of the content and peculiarities realization of the policy elements, as well as those macro-economic conditions under which the monetary policy had happened to be carried out in the course of Ukraine's transformation.

The whole process of monetary policy realization by the National Bank of Ukraine can be divided into several historical stages that reveal the complexity, difficulty, and controversy of the market transformation processes in our country and changes in the system of relations that embrace not only foreign-economic and monetary spheres, but also the whole spectrum of economic relations of the society.

Thus, basic institutional foundations of the state monetary policy realization were formed during the first stage (1991–1993), which was carried out under the conditions of a deep economic decline. The main features of the initial

period of the realization process were mainly the following: breakup of the traditional economic relations between the republics of the Former Soviet Union; considerable downswing in all branches and sectors of the economy; aggravation of the inflation processes and disruption of the internal money turnover; disarray of the state financial system and worsening of the budget deficit.

It is important to note that the main problems which accompanied the process of monetary policy realization during this period were the following:

- first, the absence of state legislation regarding monetary regulation and monetary control;
- second, low level of banking system organization in the sphere of monetary operations and monetary control;
- third, insignificant capacity of the National Bank's monetary reserves and a real threat of their full exhaustion;
- fourth, significant deficit of the balance of payments, primarily with regard to foreign-economic activities with the CIS countries;
- fifth, active usage of foreign currencies in the internal monetary turnover, which was caused by enterprises' and the population's expectations of significant inflation.

The events of 1992 reflected an actual absence of an adequate system of monetary regulation, which, among others, was caused by Ukraine's participation in the Rouble zone. In fact, during the whole year, our country's cashless payment turnover was serviced by the foreign currency – the Russian Rouble. Only since November 1992, the Ukrainian Karbovanets has become the only legal means of payment on the territory of Ukraine.

The beginning of the money-market functioning reflects the establishment of the Currency Exchange by the National Bank of Ukraine. It was reorganized into the Ukrainian Inter-Bank Currency Exchange (UIBCE) in 1993. The National Bank determined the terms and conditions of foreign currency trading, according to which the exchange rate of the Ukrainian Karbovanets to other currencies was determined at the currency exchange.

However, the main direction of the regulatory influence of the National Bank of Ukraine during this period was not the currency, but the monetary and credit policy directed at active crediting of the government and real economic sector in order to replenish the working capital of enterprises. During 1992, the number of credits issued by the National Bank to the government grew 34 times, while during 1993 it grew 7 times, which led to hyperinflation – 2100% and 10256% in the corresponding years. As a result of the uncontrolled credit emission, further production decay, rising energy prices, and unbalance of monetary turnover, the national currency has devaluated greatly: the average official exchange rate of the Ukrainian Karbovanets dropped from 208 KRB/USD in 1992 to 4539 KRB/USD in 1993.

To overcome the negative effects in the sphere of monetary relations, the National Bank of Ukraine and the government implemented a number of serious monetary policy stabilization measures. These measures included:

- 1) introducing requirements on the obligatory sale of 50% of foreign currency earnings to the state;
- 2) setting the Ukrainian Karbovanets as the only legal means of payment and imposing restrictions on foreign currency payments;
- 3) introducing considerable excise taxes on certain groups of imported goods;
- 4) limiting the bid/ask spread on foreign currency in cashless operations;
- 5) increasing the annual refinance rate for commercial banks up to 80% in 1992 and 190% in 1993;
- 6) fixing the exchange rate of the Ukrainian Karbovanets at 5970 KRB/USD;
- 7) reducing the number of transactions at the National Bank's Currency Exchange and further abeyance of the latter;
- 8) establishing a procedure of currency sales through official tender committees at an administratively determined rate.

The consequences of the abovementioned activities negatively effected the development of export operations and, thus, the country's balance of payments, which led to an increased demand for foreign currency and the risk of devaluation for the national currency. In addition to decreasing exports and foreign currency earnings, other negative moments were the increase in barter dealerships in foreign commerce and the growth of speculative operations in consequence of the emerged variance between the official Karbovanets rate and its real market rate.

The second stage of the monetary policy realization (1994–1996) was characterized by the introduction of liberalization of operations on the money-market and relative stabilization of the exchange rate of the Ukrainian Karbovanets. The main feature of this stage was the beginning of financial stabilization of the economy, at which pursued was the restrictive monetary and credit policy of the National Bank of Ukraine.

The anti-inflationary monetary and credit policy orientation of the National Bank was now based on decreasing the portion of the NBU's direct credits to the government to cover the state budget deficit; establishing the requirements for commercial banks to adjust their interest rates according to changes in the NBU's discount rate; introducing the practice of obligatory reservations for currency deposits; using state securities as an instrument of budget deficit financing.

The realization of the abovementioned restrictive activities contributed to the achievement of financial stabilization in the economy, allowed a considerable decrease in the growth rate of money supply in the turnover and attainment of a positive shift in the inflation dynamics (in 1994 – 401%, in 1995 – 181%, in 1996 – 40%, and in 1997 – already 10%).

In the sphere of monetary policy, the National Bank of Ukraine headed for liberalization and decentralization of the money-market, which brought about the implementation of the following activities by the government:

- 1) development of a decentralized money-market for achievement of which commercial banks were given a permission to purchase and sell foreign currencies at the inter-bank money-market;
- 2) broadening the list of currencies that were allowed to be traded at the exchange;
- 3) setting the rate of exchange for the national currency dependent on demand and supply as a result of an auction at UIBCE;
- 4) conducting currency interventions for the sustenance of a stable Karbovanets rate;
- 5) actively forming official national gold and foreign currency reserves;
- 6) facilitating the access of non-residents to the money-market and liberalizing the rules of using the Ukrainian Karbovanets.

Since August 1995, the National Bank of Ukraine cancelled the licence for using foreign currencies in cash as a means of payment on the territory of Ukraine, which was an important step in the direction of fighting the «dollarization» of the national economy. And the stabilization of the macro-economic situation in Ukraine in 1996 allowed creating real preconditions for holding a money reform, which was realized by changing the standard of price and establishing the national currency instead of a temporary monetary unit – the Ukrainian Karbovanets.

The third stage (1997–1998) in the work of the National Bank of Ukraine reflects the process of monetary policy realization now under the conditions of the formed national monetary and banking systems. The main features of the economy's development at this stage were the following: decelerated economic decline and gradual growth of production in certain branches; decreased interest rates in dealerships of commercial banks and broadened scope of credit investments in the economy; crisis events on the world financial market in 1997 and in Russia in 1998; an inflow of currency earnings from abroad to the domestic state bond market.

In 1997, the money-market experienced a considerable pressure as a result of attracting short-term foreign capital to cover the budget deficit by selling state bonds guaranteed to have premium bonus (in certain periods, nominal rates were 40–80% per year) issued by the government and sold through the in-

ter-bank market and UIBCE. As a result, a considerable inflow of currency funds to the internal market happened in January–August 1997, which caused an excessive US dollar supply and the pressure for devaluation on the Ukrainian Hryvnya.

But already since September 1997, because of the start of the Asian financial crisis, an outflow of short-term foreign capital has began, which reflected investors' reluctance to risk their investments in the countries with unstable economies. This called forth the pressure on the national currency for devaluation, which forced the National Bank to limit the Hryvnya rate fluctuations by introducing the exchange rate band. The negative tendencies on the Ukrainian money-market increased as a result of the financial crisis in the Russian Federation in August 1998, which was related to tight foreign trade relations between the two countries.

In order not to allow further development of crisis events in Ukraine, in the course of its monetary policy realization, the National Bank used the following instruments of strict administrative measures:

- temporary prohibition of foreign currency purchase and sales operations at the inter-bank money-market;
- realization of all purchase and sales operations only through the Ukrainian inter-bank currency exchange;
- imposition of restrictions on the sale of foreign currency by physical persons-residents;
- setting the 5% bid/ask maximum margin on foreign currency traded by commercial banks;
- introduction of restrictions on commercial banks' credits issued in foreign currencies;
- giving a permission to commercial banks to buy foreign currency on behalf of their clients only in the presence of the foreign-economic contract and certificate from tax administration;
- introducing limitations on buying foreign currency by banks-nonresidents.

As soon as the situation on the money-market was stabilized, the above-mentioned limitations were canceled and the monetary policy was again directed at further liberalization of external economic relations in general, and monetary relations in particular.

The fourth stage (starting in 1999) reflects monetary policy realization under conditions of the national economy's transition to economic growth, macro-economic stabilization, declining inflation, aroused foreign trade, and increasing positive balance of payments. The monetary policy of this period was character-

ized by gradual departure from strict administrative regulation of monetary relations to providing more liberal conditions on the internal money-market.

Thus, since March 1999, the National Bank of Ukraine has implemented the rules that regulated operations on the inter-bank money-market, which considerably liberated monetary operations and gave commercial banks more opportunities to buy and sell foreign currencies for their own needs and on the instructions of their clients, including certain types of forwards.

Further monetary policy liberalization measures included softening of some other monetary limitations, particularly those regarding the prolongation of the trade session time on the inter-bank market; broadening of the banks' opportunities to conduct operations with banking metals, including those on the international markets; increasing the limit for taking out the currency abroad by physical persons; increasing the limits of commercial banks' opened currency positions; canceling the mandatory sale of 50% of currency earnings; canceling of 5% limit on deviation of exchange rate set by exchange stations from the official exchange rate; giving a permission to commercial banks to issue credits to physical persons in foreign currency, etc.

During the whole next period, the National Bank's activities were directed at some softening of the existing system of monetary regulation and control and conducting the policy of floating exchange rate with keeping insignificant fluctuation tendencies to revaluation or devaluation.

At the beginning of 2005, the speculative expectations regarding probable strengthening of the Hryvnya rate led to a considerable inflow of foreign capital from abroad and to an increasing supply of foreign currency on the domestic market. As a result, only January through April, the amount of foreign currency redeemed by the National Bank amounted to \$4.23 billions, which caused the necessity of 4.8% Hryvnya revaluation.

But further growth of negative events, like decreasing economic growth, declining production in certain branches and export operations, worsening balance of payments, increasing inflation processes, and shrinking foreign investments led to a decrease of foreign currency supply on the money-market. Therefore, further revaluation was suspended, and the Hryvnya's rate was retained at 5.05 UAH/USD until the end of 2005.

It is important to note that the revaluation had its positive and negative effects. The positive ones were: cheapening of external debt financing; promoting of inflation decline; cheapening of imported energy carriers, machinery and equipment; increasing real income; and declining «dollarization» of savings. At the same time, the impact of revaluation on the development of export-oriented branches has negatively affected the trade balance and reduced foreign currency inflows to the internal market.

Recently, however, the maintaining of the stable Hryvnya exchange rate was set by the National Bank as the main objective of the monetary policy, ensuring the tendencies of gradual money-market liberalization and gradual refusal

from applying administrative levers to monetary relations. Today, the rate of exchange thus stands for the main «nominal anchor» in the realization of the NBU's monetary policy. At the same time, it is obvious that maintaining the Hryvnya exchange rate on a relatively low level allowed increasing production in export-oriented fields faster during the last period, foreign economic actors got a chance to plan their activities more rationally, and the National Bank of Ukraine received an opportunity to heap up considerable official gold-currency reserves by broadening its own prospects in money-market regulation. It is apparent that in perspective, according to a successful realization of the strategic tasks of economic reformation and establishment of proper market institutions, the floating exchange rate will be established, which corresponds to those monetary policy objectives that are crucial for our economy's further integration into the world economy and the WTO.

The present National Bank's monetary policy is conducted in the context of single state economic policy directed at reaching macro-economic stability and production growth. Today, the main tasks of the National Bank's monetary policy are:

- providing internal and external stability of the Hryvnya;
- promoting the «de-dollarization» of the Ukrainian economy;
- increasing gold and foreign currency reserves;
- securing balance of payments and harmonizing the interests of exporters and importers;
- improving the structure of the internal money-market;
- establishing favourable conditions for investing in national economy by residents and non-residents.

Thus, at the current stage of economic development, the peculiarities of the National Bank's monetary policy realization determine the importance and the range of tasks to be fulfilled in the context of those strategic missions that determine the needs of providing stable economic growth and stability of the national currency, creating new workplaces and improving the population's well-being, whereupon they should become an economic proof of the invariability of our country's course for European integration.

Conclusions. Each of the four historical stages of the monetary policy realization by the National Bank of Ukraine reflects the peculiarities of the macro-economic situation of the respective period that formed the corresponding policy orientation. Thus, at *the first stage*, the monetary policy was realized as a system of measured regulation directed at the establishment of organizational background of monetary regulation, monetary control, and formation of the national currency system. At *the second stage*, the NBU's monetary policy was carried out in the context of macro-economic tasks of fighting hyperinflation, guaranteeing financial stabilization and further development of the national monetary and banking

systems. At *the third stage*, the monetary policy realization was an integral part of the state regulative mechanism during financial crisis, which reflected the objective needs of its stabilization and barring the ruining of the economic system through monetary relations. *The fourth stage* reflects the very realization of the monetary policy in the context of fulfilling the tasks of sustaining the external stability of the national currency, detaining inflation, and promoting stable economic growth.

Therefore, the increasing internationalization and globalization of public economic life and the growing interdependence of national economies are the factors that strengthen the role of the monetary policy as an instrument of economic policy of the state, which directly influences not only foreign economic activities, but national economy as a whole.

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