ISSUE NO 187 | MAY 2024

NEWSLETTER
UKRAINE

German Economic Team

Garry Poluschkin

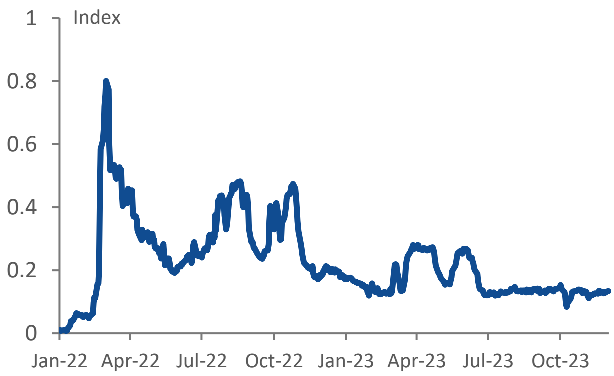
FX liberalisation at work

In the first week of May, the National Bank of Ukraine (NBU) took an important step in the liberalisation of foreign exchange flows. These measures cover six areas including, for the first time since the start of the full-scale war, a limited repatriation of dividends. This decision came after the export performance improved and the US finally approved its aid package, including direct budget support. With this approval, this year's financial commitments cover the estimated budget deficit for 2024. As a result, the NBU expects that the current level of international reserves remains stable this year. While many of the restrictions imposed will remain in place, the measures announced will improve access to finance for companies. These steps are therefore an important signal also for attracting foreign investment, especially ahead of the upcoming Ukraine Recovery Conference in Berlin in June 2024.

Background

With the start of the full-scale war in February 2022, the NBU was forced to introduce strict foreign exchange restrictions and fix the exchange rate. These restrictions included a ban on repatriation of dividends, on repayment of external loans, restrictions on transactions from foreign exchange bank accounts, and others.
Introducing such harsh measures to deal with macro-financial instability is not new to the NBU. When Russia started its aggression by occupying Crimea and parts of Donetsk and Luhansk oblasts since 2014, the NBU had introduced strict restrictions at that time. These restrictions were gradually liberalised until 2019. When the level of financial stress increased significantly with the start of the full-scale war, this prior experience supported the NBU's quick decision-making in 2022.

Level of financial stress



Source: NBU, the range of values from 0 to 1, where 0 meaning a total absence and 1 the highest level of stress.

The NBU Strategy

Over the course of the war, as the economy has slowly recovered from the initial shock, the level of financial stress has declined, allowing the NBU to take the first steps towards liberalisation as early as 2022. A key step on this path was the return to a (managed) floating exchange rate regime. In July 2023, the NBU, in consultation with the IMF, published a strategy outlining further liberalisation steps. It defined three episodes:

1) Gradual adoption of decisions to allow conducting trading operations, facilitating new investments and financing specifically through new loans and dividends. This episode is ongoing.
2) In May 2024, the second episode was launched. Further liberalisation measures for purchasing foreign currencies, for "outstanding" loans and trade finance could follow at a later stage within this episode.
3) Finally, at a future point in time, the third episode could allow more transactions for households and business with the ultimate objective to gradually return to the pre-war financial liberalisation level.

Overview of the current steps

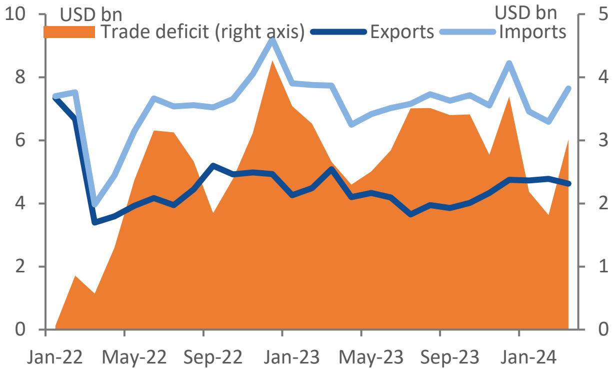
In May 2024, the NBU announced a number of measures in six areas that cover the first and second episodes. They came into force latest on 13 May 2024

1) **All restrictions on purchasing and transferring foreign currency abroad for imports of work and services are liberalised**. This area also includes fines, port / airport duties, and membership fees.
2) **Repatriation of dividends** are permitted for the financial results from January 2024 onwards, with a limit of EUR 1 m per month.
3) **Transfers on lease and rent agreements abroad is allowed for businesses**.
4) **Restrictions on the repayment of new, (received from 20 Jun-23) loans are further eased**. Now, purchasing foreign currency for principal payments is allowed for loan maturities of at least one year, and for interest payments for any loan maturity.
5) **Borrowers can transfer funds abroad to pay interest on outstanding loans (with the interest payments falling due after 24 Feb-2022)** with a limit of EUR 1 m per quarter per agreement.
6) **Representative offices of pre-defined enterprises (particularly international card payment systems) can purchase and transfer foreign currency to the accounts of a related party abroad –** a monthly limit of EUR 5 m.

Macro-financial stability is a necessary condition

This announcement came after two critical developments turned in Ukraine's favour. Firstly, the trade deficit fell by 26% after 3M2024 compared with the same period in 2023. The establishment of a new Black Sea corridor for exports, supported by insurance agreements, is a strong driver for the external improvements.

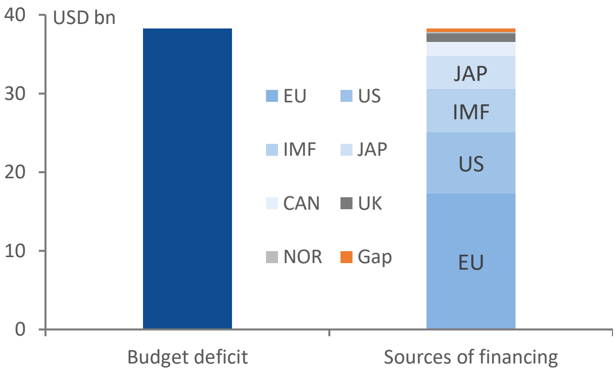
Development of external trade (goods and services)



Source: NBU

Secondly, the US has approved a financial assistance package of USD 8 bn as part of the wider support package of USD 61 bn. Following the EU's commitment of EUR 16 billion for 2024 within the Ukraine Facility pillar I and support packages by other partner countries / institutions, the budget gap is almost closed for this year.

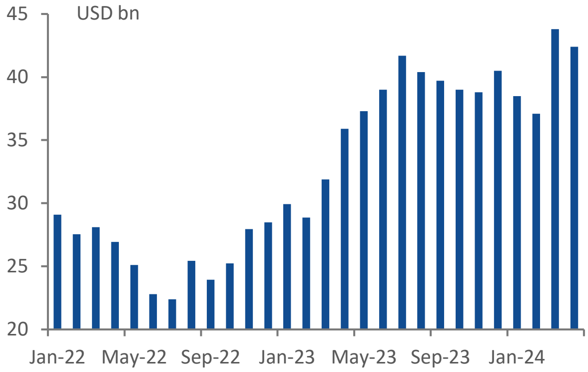
Fiscal deficit and sources of financing for 2024



Sources: IMF, Ministry of Finance of Ukraine

International reserves were on a declining path in the second half of 2023. However, they started recovering as a result of these two positive developments. In April 2024, reserves have reached USD 42.4 bn, equivalent to almost 6 months of import coverage.

International reserves



Source: NBU

Signal for private investment

The newly announced liberalisation steps send a clear signal to foreign investors. Firstly, debt financing will be simplified by further easing restrictions on cross-border loan repayments. At present, foreign enterprises do not have access to the “5-7-9” loan subsidy programme and are dependent on market-based corporate loans with interest rates of around 20% p.a. Secondly, the NBU is taking a step to liberalise the repatriation of dividends. This step directly affects existing investment. Furthermore, this measure creates a path to future repatriation opportunities for potential new investors. This signal is of particular interest as the business dimension is one of the key pillars of the upcoming Ukraine Recovery Conference (URC) in Berlin.

Outlook

The current liberalisation steps are a clear result of continued financial support and positive export developments. Similarly, future liberalisation steps will depend on the continuation of these factors, and the absence of new negative shocks.
While this signal is important for investors for the time being, it should not be seen as a “game changer” for investment attraction in the future. What counts most in the long run is a predictable and sustainable security environment and domestic reforms towards EU membership.

Financed by the Federal Ministry for Economic Affairs and Climate Action, the German Economic Team (GET) advises the governments of Ukraine, Belarus*, Moldova, Kosovo, Armenia, Georgia and Uzbekistan on economic policy matters. Berlin Economics has been commissioned with the implementation of the consultancy.
**Advisory activities in Belarus are currently suspended.*

Editors
Robert Kirchner, Garry Poluschkin
German Economic Team
www.german-economic-team.com

Implemented by
BE Berlin Economics GmbH
Schillerstraße 59 | 10627 Berlin
+49 30 / 20 61 34 64–0
info@berlin-economics.com | Imprint