Convenience for investors and issuers

Oleg Y. Churiy, Deputy Governor of the National Bank of Ukraine, gives the readers of GSS Press an insight into the deep reforms that the central bank has been carrying out, aiming at modernizing the Ukrainian financial market.

Mr. Churiy, how would you describe the current investment environment in Ukraine?
In the last years, Ukraine could not boast a considerable inflow of investment capital. According to the NBU's estimates, the net inflow of foreign direct investments in 2016 was USD 3.3 bn. However, the lion's share of investments was used for the banking sector's additional capitalization in exchange for the restructuring of debt to parent companies (USD 2.2 bn). This year, the banks no longer need such additional capitalization. As for investment to the real economy sector, the forecasted amount is at the previous year's level of around USD 1 bn.

In order to improve the investment environment, the National Bank of Ukraine, on its part, has ensured gradual recovery of economic stability. Thus, we have managed to slow down consumer inflation to 12.4 % compared to 43 % in 2015, that is, down to the target we set as part of inflation targeting. Our monetary policy has become more efficient.

An important component part of investment climate is the state of financial system. What is it like?
In 2014-2017, 87 banks were removed from the market. The 18 largest banks will complete additional capitalization. The diagnostics of loans to related parties across the banking system is coming to a close as well. The system is already 100% transparent – we know the ultimate beneficiaries of all banks now. We have eliminated the threat which Privatbank posed because of its lavish lending to related parties and shortage of capital. It is a state-owned bank now, hence, one of the most reliable banks in the market.

However, it is clear that macroeconomic stabilization and growth recovery in the banking sector is not enough. Systemic structural reforms are needed. Legal risks, which are too high, are an important constraint. They can only be mitigated on condition that the necessary bills are passed, in particular, bills on the protection of the investors' and depositors' rights, which is in the Parliament's competence. Apart from that, the reforms of the judicial system and law enforcement bodies remain another priority.

How do the tensions with neighboring Russia affect the economic development and the public finances?
The risk of escalation of hostilities on Russia's part is an important threat to Ukraine's macroeconomic and financial stability. As a result of the trading and economic restrictions put in place, Ukrainian exports to Russia shrank by 26% in 2016, driven primarily by the reduction of machine-building exports.

However, certain positive effects were reached as well. Finally we can say that we have redirected our exports to other markets and become less dependent on Russia in economic terms. Russia's share in the Ukrainian exports currently amounts to 9%, while just a couple of years ago it exceeded 30%. Instead, domestic manufacturers are gradually expanding their presence in the EU market owing to the trading preferences received. And although it is those manufactures, which had already supplied their products to the European market before the preferences were granted, who are best in doing this for now, the overall trend is definitely positive. Ukraine already sends 32% of its exports to the EU countries.

Last September, an ambitious financial markets reform concept, prepared by NBU and NSSMC has been presented. Where are we now in this project?

The presented concept is ambitious indeed, however, it is feasible, and it is being implemented already. Active efforts towards the change of the stock market infrastructure are currently being taken, jointly with the state regulator of the stock market, the National Depository and the market players. Our aim is to make it up-to-date and convenient for investors and issuers.

The definition of the target post trade model, which will support the development of the capital markets in Ukraine for various asset classes, is now on the agenda. It must comply with the EU requirements and be built on the basis of the best practices, including the establishment of a single securities depository and making settlements in the central bank's money. It is also important to create a road map to ensure smooth functioning of the market in the implementation of the necessary steps to achieve the target model. This concerns, in particular, the conditions to implement the project of handing over the securities, which are on the NBU's books, for the servicing to the National Depository. Such key prerequisites include smooth carrying out of monetary operations by the National Bank, in particular, operations related to commercial banks' refinancing and ensuring safe keeping of government securities and the settlements under transactions with them.

The reform will bring the possibility to open accounts for International Central Securities Depositories (ICSDs) with the NBU depository before the transfer of government securities to the NDU (CSD). What was the idea behind?

Today, it is our priority to open accounts for the leading international central securities depositories with the NBU depository and the National Depository of Ukraine, as part of transformation and development of the financial market infrastructure. The opening of these accounts will enable us to link our system to the global depository structure. This, in turn, will facilitate the access for foreign investors to the Ukrainian capital market and make it possible for the Ministry of Finance to mitigate risks with wider diversification of investor base and increase of the share of domestic currency borrowings.

Subsequently, when a single depository is created, ICDS accounts will be opened in the new institution.

The local market and investors have been waiting for FX liberalization for a long time, so the concept presented in November was perceived with great interest. When exactly can we expect the first signs of a more liberal regime?

We are gradually alleviating the foreign currency market restrictions, which were introduced in 2014-2015 for stabilization purpose. In particular, in the last year, we have softened the requirement of the obligatory sale of foreign currency earnings (from 75% to 65%), extended the period of settlements under product export and import operations to up to 120 days, lifted the requirement of the obligatory sale of funds received for foreign investments in Ukraine, allowed the repatriation of dividends accrued to foreign investors in 2014-2015 and reduced the period of reserving of UAH funds by banks for the purchase of foreign currency to one day. We also plan to consider a possibility to allow repatriation of dividends accrued in 2016 soon.

However, we should understand two things. First and foremost, we can alleviate foreign currency restrictions only if favorable preconditions exist in the monetary and foreign currency markets and the Ukrainian economy in general. Otherwise, we risk to provoke an unjustified devaluation pressure on hryvnia. Secondly, we have to choose between the alleviation of restrictions and growth of international reserves, even if favourable conditions exist. It is not possible to carry out foreign exchange liberalization and purchase foreign currency at the same time, because this creates a threat of excessive volatility in the foreign currency market.

What will the FX regulation look like in the future?

We plan to adopt a brand-new model of foreign currency regulation. Liberalization will be implemented gradually, in several concurrent stages. At the first stage, we intend to lift restrictions for export and import operations and direct foreign investments, which are aimed at increasing our country's export potential. Then, we shall lift the restrictions for portfolio investments and debt capital flows. And finally, all obstacles for individuals' cross-border financial operations will be removed.

Our approach is based on the understanding that the liberalization of foreign currency regulation should not interfere with the financial system's stability, which is still fragile.

What is your position with respect to the consolidated oversight model stipulating the split of responsibilities for financial markets regulation between NBU and NSSMC?

The split of the functions of the two bodies will make state regulation of the financial market more transparent and facilitate optimization of regulatory influence on its participants. Consolidated supervision will increase the protection and thus boost the confidence of financial services' consumers in the market.

The National Bank has all instruments to ensure effective supervision over the banking and non-banking financial services markets at the same time.