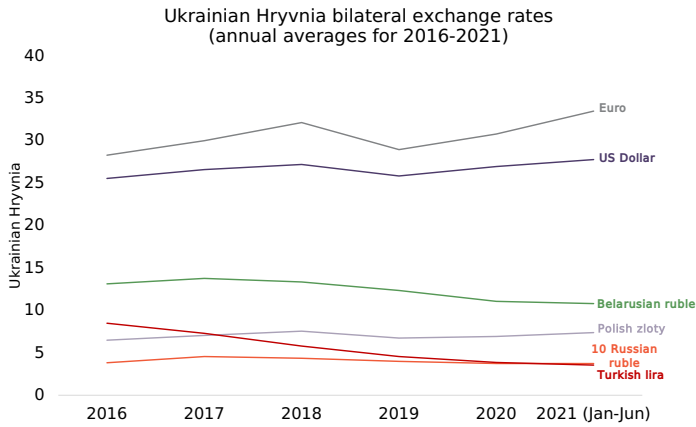




The Ukrainian Hryvnia's exchange rates relative to foreign currencies experienced some noteworthy tendencies in 2016-2021. This period of course includes the ongoing COVID-19 pandemic, which has had a significant impact on exchange rate fluctuations globally. Typically, countries with worsening epidemiological situations have tended to suffer from currency depreciation, while those improving their case numbers have recorded currency appreciation (for instance, the Chinese Yuan underwent depreciation until mid-May 2020 in relation to USD, but recovered well in July-September 2020)¹. Broadly speaking, developing countries are more sensitive to fluctuations caused by the pandemic due to withdrawals of capital by international investors. According to the Institute of International Finance, in the first two months of the pandemic (between early February and early April of 2020) around USD 100 bln were withdrawn from developing and emerging countries². In this bulletin, the exchange rate fluctuations in Ukraine in 2016-2021 will be reviewed, as well as some of the factors affecting it.

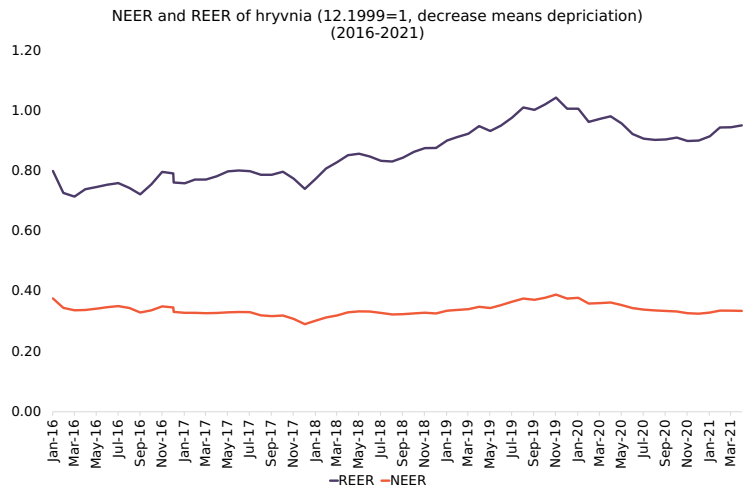


Source: National Bank of Ukraine

An analysis of the annual average bilateral exchange rates of the Ukrainian Hryvnia reveals a trend of depreciation against all major trading partner currencies over 2016-2021, except for the Turkish Lira and the Belarusian Ruble. Both of these currencies have been steadily depreciating against the Ukrainian Hryvnia in the course of 2016-2021. Meanwhile, the Polish Zloty and the Russian Ruble recorded only minor appreciation against the Ukrainian Hryvnia.

In 2016-2021, the Ukrainian Hryvnia depreciated against the US Dollar year on year, with the exception of 2019, when the Ukrainian Hryvnia appreciated against the US Dollar by 5.2%, compared to 2018. In 2020, compared to 2019, the Hryvnia experienced 4% depreciation against the US dollar. Moreover, the trend has continued into the first two quarters of 2021, when the Ukrainian Hryvnia has depreciated against the US Dollar by 6.5%, compared to the same period of 2020.

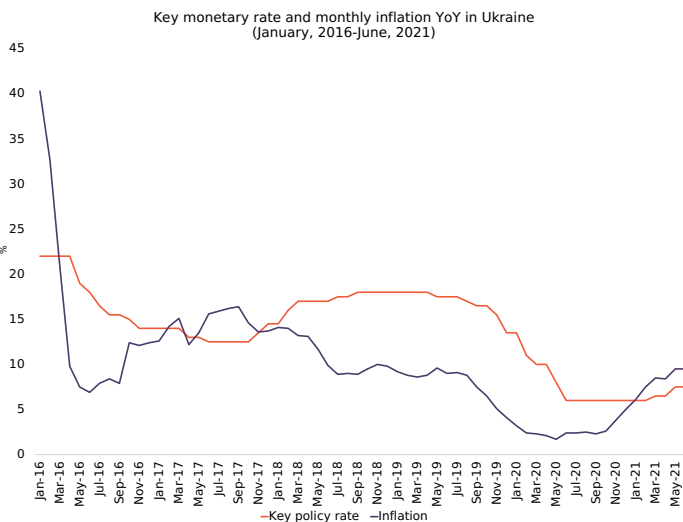
The Nominal Effective Exchange Rate (NEER), which measures Ukraine's international competitiveness in terms of the foreign exchange market, was relatively stable throughout 2016-2018. In 2019, the average annual NEER index increased by 10.8%, meaning that the Hryvnia appreciated against Ukraine's trading partners' currencies, however in 2020 it fell by 1.5% and continued to decrease in 2021.



Source: National Bank of Ukraine

Furthermore, the Real Effective Exchange Rate (REER) of the Ukrainian Hryvnia, which is the indicator of changes in the price competitiveness of Ukrainian goods relative to goods produced in Ukraine's main trading partner countries, was relatively stable over 2016-2017. Since the beginning of 2018, a steep appreciation trend was noticeable until the end of 2019. In 2019, the average annual REER peaked with a 15.5% increase compared to 2018. Such appreciation means that Ukrainian goods became more expensive compared to foreign goods, potentially threatening the competitiveness of Ukraine's exports. However, slight depreciation came in 2020, compared to 2019 and this trend continued in 2021.

Inflation and key monetary rate are highly interrelated with exchange rates, meaning it is important to overview the dynamics of these indicators in this period.

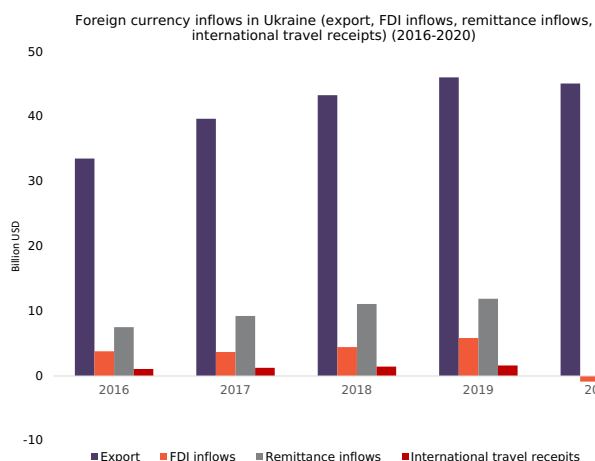


Source: National Bank of Ukraine

In 2019, the annual inflation rate in Ukraine was 7.9%, representing a 3.1 percentage point decrease, compared to the annual inflation rate in 2018. There could be some correlation between the abovementioned decrease in inflation rate and the appreciation of the Hryvnia in relation to the US Dollar in this period. In 2020, inflation further decreased by 5.2 percentage points compared to 2019 and amounted to 2.7%, while the Hryvnia depreciated in the same time period against the US Dollar.

An increase in the key monetary rate in 2018 (a 2.6 percentage point increase, compared to 2017) and sustained increase in 2019 could attribute to decreased inflation over this period. In 2020, the key monetary rate decreased in pursuit of economic expansion after the recession caused by COVID-19, and could be one of the reasons behind the rise of inflation since November 2020. In the beginning of 2021 key monetary rate was characterized with an upward trend.

One of the most important factors affecting exchange rate fluctuations are capital inflows, which increase the demand for domestic currency, therefore increasing its value.

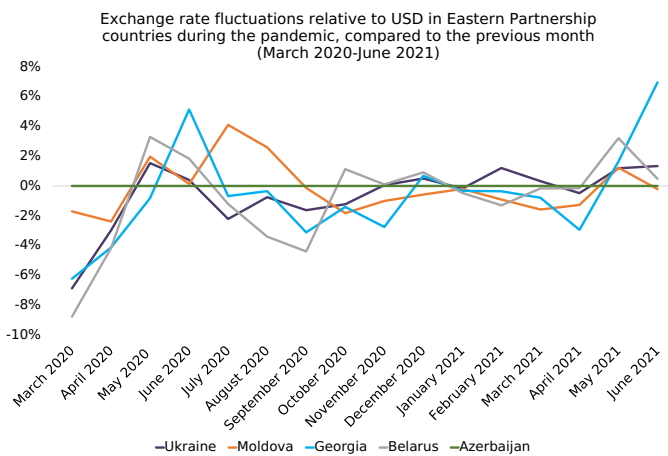


Source: National Bank of Ukraine

External debt³ is considered to have a strong effect on the exchange rate, therefore it is important to overview its dynamics in the reported period.

In the 2016-2020 period, the gross external debt of Ukraine recorded the average annual growth rate of 1.4%. As of the end of 2020, the gross external debt of Ukraine amounted to USD 125.8 bln, representing a 3.3% increase compared to 2019. It is worth noting that as of the end of 2020 the gross external debt, expressed as percentage of GDP, amounted to 81.3% in 2020, which is a 2.8 percentage points increase, compared to 2019.

To compare Ukraine's external debt growth figures with some of the EaP countries, Moldova's gross external debt increased by 12.7% by the end of 2020⁴, compared to the end of 2019, and amounted to 8.4 bln USD while Georgia's figure increased by 10.4%⁵ and amounted to 20.6 bln USD.

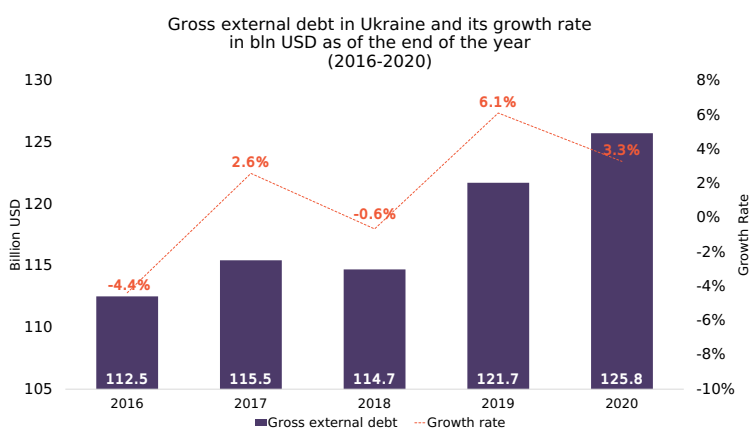


Source: National Banks of respective countries; PMC RC's calculations

Throughout the past five years, different types of foreign currency inflows have been characterized by some noteworthy trends. In the analyzed period of 2016-2019, exports represented the largest foreign currency inflow in Ukraine.

In 2019, exports, FDI inflows, remittance inflows, and international travel receipts increased, compared to 2018, by USD 2.8 bln, USD 1.4 bln, USD 0.8 bln, and USD 0.2 bln, respectively. The increased inflows could be among the major factors behind the appreciation of the Hryvnia in relation to the US Dollar in 2019, compared to 2018.

In 2020 all of the pertinent factors underwent a decrease, compared to 2019. FDI inflows, international travel receipts, and volume of exports all decreased by USD 6.7 bln, USD 1.2 bln, USD 0.9 bln, respectively, while remittance inflows were more resilient, with only a USD 0.03 bln decrease. The decline of inflows could have been the main contributor to the depreciation of the Hryvnia against the US Dollar in 2020, compared to 2019.



Source: National Bank of Ukraine; PMC RC's calculations

In the period of March 2020 to June 2021, when the economy of Eastern Partnership countries experienced shocks caused by the pandemic, the exchange rate was one of the most volatile factors.

In March 2020, when governments started to impose their first COVID-19-related restrictions, four out of the five reviewed EaP countries (Ukraine, Georgia, Moldova, Belarus)⁶ recorded currency depreciation in relation to the US Dollar, compared to February 2020. In this period, Hryvnia depreciated by 6.9%. Azerbaijan, whose currency is stringently pegged to the US Dollar, did not encounter any fluctuations. It is worth noting that Belarus had the worst currency depreciation (-8.8%) in March 2020, compared to February 2020.

Overall, in the period of March 2020 to June 2021, the Ukrainian Hryvnia depreciated by 3% relative to the US Dollar, which is better compared to the Georgian Lari and the Belarussian Ruble, which suffered 3.8% and 4.6% depreciation, respectively.

The Ukrainian Hryvnia's overall depreciation against Ukraine's main trading partners' currencies (mainly USD), especially in 2020-2021, could be attributed to a significant decrease in capital inflows in 2020 (USD 6.7 bln decrease in FDI; USD 1.2 bln decrease in international travel receipts; USD 0.9 bln decrease in exports). It could be argued that a decrease of average inflation (a decrease by 5.2 percentage points, compared to 2019, and amounting to 2.7%), should have had a positive effect on the value of the currency, but it was outweighed by other factors, mainly the decreased volume of foreign currency inflows.

1 Source: <https://www.cmegroup.com/education/featured-reports/covid-19s-influence-on-exchange-rates.html>

2 Source: <https://www.worldbank.org/en/news/press-release/2020/10/29/covid-19-remittance-flows-to-shrink-14-by-2021>

3 Gross external debt refers to money borrowed from outside the country by the general government, Central Bank and other deposit taking organizations as well as other sectors.

4 Source: <https://www.bnm.md/en/content/statistical-bulletin-nr-1-2021-external-debt-republic-moldova-31122020-preliminary-data>

5 Source: National Bank of Georgia; PMC RC's calculations.

6 The graph and analysis do not include figures of Armenia.

Basic Economic Indicators	2017	2018	2019	2020	2021 Q1
Nominal GDP (bln hryvnia)	2,984	3,561	3,975	4,194	1,009
GDP per Capita (USD, PPP)	11,871	12,629	13,341	13,057	-
GDP Real Growth (%)	2.5%	3.4%	3.2%	-4.0%	-1.2%
Yearly inflation (%)	14.4%	10.9%	7.9%	2.7%	7.4%
Exchange rate (hryvnia/USD)	26.6	27.2	25.8	27.0	28.0
FDI (BOP net inflows) (bln USD)	3.7	4.5	5.9	-0.9	-
Unemployment Rate (%)	9.9%	9.1%	8.6%	9.5%	10.5%
Gross external Debt (bln USD)	115.5	114.7	121.7	125.7	123.1

* preliminary data