

Foreign Exchange Intervention Strategy of the National Bank of Ukraine for 2016-2019

I. General provisions

1. The Foreign Exchange Intervention Strategy (hereinafter – the Strategy) sets out the basis for the National Bank of Ukraine (hereinafter – the NBU) to conduct operations on sales, purchase, and exchange of foreign currency on the foreign exchange market (hereinafter – the foreign exchange interventions) based on the powers set forth in Articles 28 and 46 of the Law of Ukraine *On the National Bank of Ukraine*.

2. The Strategy details relevant provisions of the NBU's strategic documents on monetary policy.

II. Goal, tasks and principles of foreign exchange interventions

3. The legally established goal of foreign exchange interventions shall be understood as the impact on exchange rate of the domestic currency in terms of foreign currencies and general demand and supply of the money in Ukraine. It shall be in conformity with the goals of the NBU, where achievement and maintenance of price stability is the prioritized one.

4. When deciding on the policy of foreign exchange interventions the NBU shall consider the following factors:

1) a limited level of international reserves of the NBU, which increases the vulnerability of the financial system and economy of Ukraine to unfavorable events and risk perception by foreign and domestic investors;

2) insignificant depth and liquidity of the foreign exchange market, which necessitate an active role of the NBU in leveling imbalances between the demand and supply as well as avoiding signs of market dysfunction;

3) conduct of a monetary policy on the basis of the inflation targeting regime, including an initial stage of implementing a key policy rate as the main instrument of

the monetary policy as well as a relatively weak interest rate channel of the monetary transmission;

4) a high level of dollarization and considerable effect of transferring exchange rate changes to inflation; and

5) the NBU's focusing on minimization of its interference with operation of the foreign exchange market along the way of development of the foreign exchange market and self-balancing mechanisms thereof.

5. The aforementioned factors provide for the following tasks on conducting foreign exchange interventions by the NBU:

accumulation of international reserves. A sufficient level of international reserves is a protective mechanism for Ukraine's financial system and economy against external shocks and it also facilitates increase of confidence of domestic and foreign investors to its stability. Target benchmarks regarding international reserves level are determined in the program for cooperation between Ukraine and the International Monetary Fund or by a decision of the NBU Board in accordance with the generally accepted adequacy criteria;

leveling of foreign exchange market functioning. This is necessary so that to avoid negative impact of excess volatility of the exchange rate and extraordinary events on the foreign exchange market on the price and financial stability; and

maintenance of the transmission of a key policy rate as the main instrument of the monetary policy. This can be necessary in order to achieve goals and tasks of the monetary policy in a more efficient manner.

6. Conduct of foreign exchange interventions can be focused on fulfillment of one or several tasks mentioned above. Even if the goal of achieving price stability and task on accumulation of international reserves in the short run support each other, they can be incompatible in the medium term. In such a case, the achievement of price stability is prioritized.

7. General principles of foreign exchange interventions shall be the following regardless the tasks for which they are performed by the NBU:

1) the foreign exchange intervention strategy corresponds to the inflation targeting regime and floating exchange rate. Therefore, foreign exchange interventions play a supporting role in terms of a key policy rate as the main instrument of the monetary policy;

2) the role, scopes and frequency of foreign exchange interventions shall decrease along with development of financial markets, improvement of their ability to self-regulation, liberalization of the foreign exchange law and accumulation of international reserves up to the level required. The NBU shall strive for minimization of using such tool;

3) conducting foreign exchange interventions the NBU shall not counteract fundamental trends and shall only level effects of their coming into being. Fulfilling tasks on conducting foreign exchange interventions, it opens up an opportunity to prevent accumulation of external and financial imbalances; foreign exchange intervention is not aimed at reaching predetermined exchange rate target, it only affects magnitude and speed of exchange rate adjustment;

4) during FX interventions, the NBU will favor forms of interventions according to which the NBU will not offer but rather accept the price offered by other foreign exchange market traders; and

5) criteria of market players' participation in foreign exchange interventions shall be open and transparent and determined in the regulatory acts of the NBU. If a framework of market makers is set up, the NBU shall conduct foreign exchange interventions mainly through the market players, which receive a status of market makers pursuant to the established procedures.

III. Forms of foreign exchange interventions

8. Foreign exchange interventions can be conducted in the following forms:

a foreign exchange auction – transactions are conducted through distribution of the fixed amount of interventions between the market traders that offered the best price for purchase/sale of foreign currency;

a single rate intervention – conducted through either gathering market traders' bids for purchase, sale or exchange of foreign currency at a fixed single rate followed by proportional approval of requests within the total amount of the foreign exchange intervention or by quoting a foreign exchange ask/bid in the electronic trading platform at the single exchange rate and executing contracts with traders according to first-in-first-out acceptance of the bid until the foreign exchange intervention amount runs out;

a best rate intervention – conducted by either requesting ask/bid prices for foreign currency from market traders in electronic trading platforms and executing contracts with the trader offering the best price or by selecting the best ask/bid price for foreign currency quoted by market traders in the current electronic trading platforms and executing contracts with the trader offering this best price; and

a targeted intervention – caused by national interests of Ukraine; it is used in exceptional circumstances and based on a request from the Government of Ukraine.

IV. Peculiarities of foreign exchange interventions

9. Foreign exchange interventions intended for accumulation of international reserves shall be conducted for the purpose of gradual achievement of their target level. Such interventions shall be conducted subject to excess of supply for foreign currency over demand on it. Conducting foreign exchange interventions shall not result in changing a fundamental trend of the exchange rate or its actual pegging at one level.

As a rule, foreign exchange interventions intended for accumulation of international reserves shall be effected primarily in the form where the NBU will not offer but rather accept the price offered by other foreign exchange market traders. Once the international reserves reach a target level, foreign exchange interventions for accumulation thereof shall stop. In case of changing the estimation of a target level of international reserves such foreign exchange interventions can continue.

10. Foreign exchange interventions intended for leveling the functioning of the foreign exchange market shall be conducted in the following cases:

1) limited possibility for the foreign exchange market self-balancing as a result of existing foreign exchange restrictions and/or substantial impact of situational factors (mismatching of days- off in Ukraine and on international foreign exchange markets, periods of considerable payments to the state budget, considerable receipts/transfers of foreign currency and others). In this case, the NBU shall be entitled to purchase, sell or exchange foreign currency in the amount required to ensure appropriate functioning of the foreign exchange market.

Volumes of possible foreign exchange interventions shall be determined based on analysis and forecast of demand and supply of foreign currency as well as assessment of a possible (current) imbalance between them. Foreign exchange interventions can be performed in any form.

Along with the weakening/removal of foreign exchange restrictions, development of financial markets (including an increase of the depth and liquidity of the foreign exchange market), the reason for conducting such foreign exchange interventions shall gradually disappear.

An important characteristic of such foreign exchange interventions is the fact that they do not affect a fundamental trend of exchange rate changes;

2) malfunction of the foreign exchange market and/or the temporary loss of benchmarks for pricing by the foreign exchange market: if the foreign exchange market does not efficiently function as a result of considerable domestic or foreign shocks, the NBU shall have the right to conduct foreign exchange interventions for the purpose of recovering the functioning of the foreign exchange market. Under such conditions, the NBU can be a buyer and seller of foreign currency simultaneously. The goal of the NBU shall be to recover liquidity of the foreign exchange market.

Such foreign exchange interventions shall not be conducted in one direction during a long period of time and stop upon occurrence of an appropriate effect or in case of being replaced by more efficient methods of resistance to shocks (including by measures of foreign exchange regulation).

Provided such conditions the volumes and form of foreign exchange interventions shall be determined by the nature of a shock and specific circumstances accompanying it. For the purpose of provision of foreign exchange market players with a starting point for market pricing, a foreign exchange intervention under a unified exchange rate shall apply in the first place;

3) excess volatility of the exchange rate, which carries substantial risks for the economy's business entities, considerable deterioration of their expectations and relevant negative consequences for price and financial stability. The volumes of possible foreign exchange interventions, their form and tactics shall be determined on the basis of comparing the speed of exchange rate adjustment with the level of volatility, which is considered to be excessive by the NBU. Such parameters of foreign exchange interventions are specified in the administrative documents of the NBU and shall not be public information.

11. To support the transmission of a key policy rate as the main instrument of the monetary policy, foreign exchange interventions shall be conducted in case there are analytically justified assessments evidencing that:

applying only a key policy rate as the main instrument of the monetary policy shall not provide any opportunity to achieve the established inflation goals in the most efficient manner at an acceptable time horizon;

supporting a key policy rate as the main instrument of the monetary policy using foreign exchange interventions shall allow achieving goals and tasks of the monetary policy in the most efficient (least costly for the economy of Ukraine) manner;

interference of the NBU with the processes of exchange rate formation shall not generate any false perception of foreign exchange risks by economic agents and result in accumulation of external and financial imbalances.

A foreign exchange intervention shall be conducted in the same direction (weakening/strengthening of monetary conditions) where a key policy rate is used. However, a foreign exchange intervention shall apply only as a supporting tool, i.e. after the change of a key policy rate in a relevant direction.

Parameters of possible support in achieving inflation goals by foreign exchange interventions shall be determined by the NBU Board and shall not be public information.

V. Communications policy

12. The Strategy also specifies communications framework in the sphere of foreign exchange interventions.

13. The NBU adheres to reasonable transparency when publishing information on the intentions to conduct foreign exchange interventions, motives and results of such foreign exchange interventions.

1. Announcing the conduct of foreign exchange interventions

14. The NBU shall publish a notice about the conduct of foreign exchange auctions on the website of the Official Internet Representation of the NBU on the day of conducting them.

15. The NBU shall not publish an announcement on the conduct of foreign exchange interventions in any other forms in order to ensure their efficiency.

2. Motives of foreign exchange interventions

16. The NBU shall outline general motives of foreign exchange interventions in the public statements of duly authorized persons, namely, in press releases as well as in its regular publications.

17. In view of high sensitivity of the information, the NBU shall have the right to refrain from disclosure of detailed motives of conducting each particular foreign exchange intervention.

3. Results of foreign exchange interventions

18. The NBU shall publish results of foreign exchange auctions on the day of conducting them on the website of the Official Internet Representation of the NBU.

Results of other foreign exchange interventions can be published by the NBU on the website of the Official Internet Representation of the NBU.

Moreover, the general results of foreign exchange interventions in all forms can be given in public statements of the NBU's duly authorized persons, if necessary.

19. Generalized information on the conduct of foreign exchange interventions in all forms shall be published by the NBU on the website of the Official Internet Representation of the NBU once per month no later than the fifth business day following expiration of an accounting month.