Floating Exchange Rate as Indispensable Condition of Maintaining the Stability of National Currency

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Type of exchange rate issue is very important because changing it usually leads to significant transformation of the economy. Moreover, changes in the exchange rate have a direct impact on international trade. The policy of "fixing" the hryvnia against other currencies was not effective, and even risky for Ukraine as long deficit covered by loan funds, and for the maintenance of the hryvnia currency reserves were involved.

In countries with a market economy and high income tend to operate market (floating) exchange rates.

A floating exchange rate is a regime where the currency price is set by the forex market based on supply and demand compared with other currencies. This is in contrast to a fixed exchange rate, in which the government entirely or predominantly determines the rate.

In extreme situations such as political unrest, terrorist attacks or natural disasters a country’s currency may experience a period of heavy selling that causes the depreciation in value. The country’s central bank may intervene in order to restore the value of the currency. A central bank regime that routinely intervenes would use the term "managed float". Sometimes, the central bank may set upper and lower bounds known as price ceilings and floors, respectively, and intervene whenever those bounds are reached.

In 2014 the decision of the NBU was the transition to a flexible exchange rate (Fig.1). After changing the rate hryvnia began falling against foreign currencies.   
The reaction of society was mostly negative. For large companies, firms and entrepreneurs it nearly became heavier to import; goods from abroad have become less available. The market price of the currency "jumped" higher than 30 UAH per 1 US dollar (in 2015).

Figure 1.UAH exchange rate fell down in 2014.

National Bank, in order to reduce pressure on the exchange rate, had to act decisively, in 2014-2015 was implemented foreign exchange intervention policy, prohibition of foreign currency loans and raising the exchange rate to 30% (at the end of 2015 decreased to 22%).

It should be noted that the introduction of a flexible exchange rate was not the cause of devaluation of the hryvnia, but it was a necessary measure. This transition revealed significant imbalances of the Ukrainian economy. The government was able to deal with obvious difficulties, which were hidden earlier.

National Bank of Ukraine conducts inflation targeting. The main characteristic of this policy is the availability of a flexible exchange rate.

If a fixed rate was not abolished, it would have threatened the existence of the state economy. However, the anti-crisis measures of the government and the NBU have given good results. At present, the discount rate is 14% (too many, but not critical in comparison with the situation in 2015.). The inflation rate remains at 14.2%.

Floating exchange rate is a necessary condition for the stability not only of the national currency but Ukraine's economy as a whole. The flexible course is characterised by efficiency at predictable monetary and fiscal policy, controlled "floating", as well as at the balance of payments crisis. The transition to a floating exchange rate gave rise to changes such as reducing the pressure on the central bank; the formation of the hryvnia exchange rate on the basis of supply and demand on the market; reflect the real balance of trade, taking into account the actual exchange rate.

The abolition of fixed rate was more than reasonable in terms of excessive inflation, the balance of payments crisis and the reduction of foreign exchange reserves. The fixed rate is not described as quite inefficient policy, but each rate is effective in different situations and a government had to change the rate.

According to forecasts the economy will have a better position and will be more competitive, but the trade balance will remain negative for a long time. That is why the floating rate policy, in any case, should be continued.

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