Andriy Pyshnyy: National Bank of Ukraine press briefing - monetary policy decisions

Speech by Mr Andriy Pyshnyy, Governor of the National Bank of Ukraine, at a press briefing on monetary policy decisions, Kyiv, 15 June 2023.

* * *

Dear colleagues,

The Board of the National Bank of Ukraine has decided to keep its key policy rate at 25% per annum.

This will help maintain the attractiveness of hryvnia-denominated instruments, preserve the sustainability of the FX market, and reduce inflation. Combined, these results will pave the way for the further easing of FX restrictions.

- **The pace of consumer price growth continued to decline faster than expected.**

Inflation eased to 15.3% yoy in May. Apart from the base effect, the pullback in inflation was driven by an ample supply of food and fuel, a stronger hryvnia cash exchange rate, and improved exchange-rate and inflation expectations.

Among other things, the NBU's efforts to keep the key policy rate high and make hryvnia instruments more attractive made it possible to stabilize the FX market and improve expectations.

Although headline inflation has decelerated, underlying inflationary pressures remain rather high.

- **Thanks to the removal of supply chain disruptions, the reduction of prices in the global commodity markets, and the NBU's consistent monetary policy, the central bank expects that inflation in Ukraine will continue to decelerate.**

However, this process will not be as rapid as in previous months.

First, the base effect, which contributed to a significant drop in inflation in H1 2023, will gradually fade.

Second, price dynamics will be affected by increases in certain utility tariffs and the announced return of pre-war taxes on fuels.

In addition, the destruction of the Kakhovka HPP Dam will have an adverse impact on prices.

By the NBU's early estimates, this will contribute about 0.3 pp to this year's inflation rate because of how it has complicated the operation of multiple enterprises, and due to the partial loss of crops, primarily vegetables, that it has led to.

- **The war is taking an increasingly large toll, but steady inflows of international aid and the revival of the domestic debt market have made it possible to cover the significant budget deficit without resorting to monetary financing.**

Since the beginning of the year, international partners have granted Ukraine about USD 20 billion in assistance.

In addition, the NBU's and the government's joint efforts have increased the amount of funds that goes into the state budget from the sale of domestic government debt securities.

All of this made it possible to successfully finance the significant deficit of the state budget in January–May.

Given the sustainability of international support and the gradual revival of the economy, Ukraine will be able to continue to cover all necessary expenditures without going back to monetary financing.

- **The key risk to inflation dynamics and economic development is the longer duration, and the unpredictable nature and intensity, of the full-scale war.**

Although Ukraine is gradually liberating its territories, high uncertainty persists over when the active phase of hostilities will end.

Targeted attacks have led to the loss of civilian lives and caused environmental disasters. The long-term effects of the destruction of the Kakhovka HPP are unprecedented in magnitude. It will take time to fully assess them.

The prolongation of hostilities continue to threaten Ukraine with significant losses of economic potential and with unpredictable inflationary shocks.

Other risks also persist. They include:

- the continued destruction of critical infrastructure facilities, including energy infrastructure
- the emergence of additional budget needs and substantial quasi-fiscal deficits, including in the energy sector and
- disruptions or a shutdown of the "grain corridor" and the ongoing limitations imposed on imports of Ukrainian food by some European countries.

Conversely, the rapid implementation of Ukraine's recovery project, together with European integration reforms, could considerably accelerate the pace of economic growth and reduce inflation at a faster rate.

- **In order to maintain exchange rate sustainability, with a view to ensuring a decline in inflation and creating the right conditions for an easing in FX restrictions, it is important that hryvnia instruments remain highly attractive. In view of that, the NBU Board decided to keep the key policy rate at 25% per annum.**

The key policy rate continues to play an important supporting role in ensuring the sustainability of the FX market and protecting international reserves.

Keeping the key policy rate unchanged, together with other NBU measures, was instrumental in substantially increasing the attractiveness of hryvnia instruments.

This has bolstered households' interest in hryvnia deposits and domestic government debt securities in recent months. Time hryvnia deposits also returned to growth.

Coupled with other factors, this helped boost the resilience of the FX market, laying the foundations for a continued easing in FX restrictions.

- **The NBU allowed residents to transfer money abroad, with a view to repaying certain foreign loans.**

What is more, the central bank is currently working on additional measures to ease FX restrictions.

- **The NBU will continue to deliver the monetary conditions required for maintaining exchange rate sustainability and ensuring a steady drop in inflation.**

The NBU is ready to start a monetary easing cycle earlier than it envisaged in its April macroeconomic forecast. If the growth in real yields on hryvnia instruments and the reduction of risks to exchange rate sustainability continue to occur faster than expected.

This could be facilitated by a faster decline in consumer and core inflation and a more rapid increase in international reserves than envisaged in the forecast, as well as by the greater effectiveness of the measures taken to make hryvnia instruments attractive.

Obstacles to a faster transition to a monetary easing cycle could arise from new challenges for exchange rate sustainability and a steady drop in inflation resulting from the Russian invasion.

Thank you for your attention!