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, 14 September 2023.

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The Board of the National Bank of Ukraine has today decided to cut the key policy rate to 20%.

The further pullback in inflation and the NBU's ability to ensure FX market sustainability are making it possible to continue the cycle of key policy rate cuts while maintaining the sufficient attractiveness of hryvnia savings.

Such a step will support the economic recovery without posing threats to macrofinancial stability.

Although headline inflation has been declining faster than expected, core inflation is close to the NBU's forecast

In year-on-year terms, inflation slowed to 8.6% in August. Price movements came out better than the NBU anticipated, primarily due to an increase in the supply of food products.

However, the drop in core inflation (down to 10% in year-on-year terms) was close to the forecast the NBU made in July. The NBU's measures to keep hryvnia assets attractive and the FX market sustainable played an important role in easing underlying price pressures. Among other things, the NBU's actions helped further improve exchange-rate and inflation expectations.

The overall downtrend in inflation is set to persist, but there is little to no potential for a rapid slowdown in price growth

On the one hand, better harvests will continue to restrain price increases in the following months. The impact of the fixing of some utility tariffs will also remain. The NBU is committed to persevere in ensuring the sustainability of the FX market to keep exchange-rate and inflation expectations in check.

On the other hand, business costs will remain under significant pressure to increase because of war-related losses as well as higher prices for electricity and fuel.

Although significant amounts of official financing have maintained Ukraine's international reserves at a high level, further international support is vital amid significant budgetary needs

Official financing enables the NBU not only to make up for a significant shortage of foreign currency in the market, but also to maintain international reserves at a high level. In August, they exceeded USD 40 billion.

Budget revenues and investments are not sufficient to meet expenditures. International aid will therefore continue to be the primary guarantee that the budget is funded without relying on central bank financing. With this in mind, it is critically important to meet the conditions of the IMF-supported program on time and in full.

War grinds on and remains a key risk to the economy and inflation developments

High uncertainty persists over when the active phase of hostilities may come to an end. Prolongation of hostilities continue to pose the risk of dealing more significant damage to the Ukrainian economy's potential and triggering unpredictable inflationary shocks.

Other risks also persist, including:

- decreased amounts or disruptions of international aid disbursements, in part due to failure to meet the conditions of the IMF-supported program on time or in full
- the emergence of additional budget needs to maintain defense capabilities and substantial quasi-fiscal deficits, in the energy sector in particular
- the resumption of significant power shortages because of the substantial damage sustained by energy infrastructure, which will restrain economic activity and exports, fuel the growth in imports, and raise pressure on the FX market and therefore on consumer prices
- ongoing difficulties with exporting agricultural products, in particular if countries extend or expand their trade restrictions, and if the shelling of port and agricultural infrastructure continues amid the termination of the Black Sea Grain Initiative.

Taking into account the balance of risks, a sharp fall in inflation, and the NBU's ability to safeguard exchange rate stability, the NBU Board decided to cut the key policy rate, to 20%.

The cycle of interest rate policy easing the NBU launched in July decreased nominal interest rates in the banking system, as was to be expected. In spite of that, the yields of hryvnia assets remained attractive, thanks to the dramatic fall in inflation and improved expectations.

Interest rates on term hryvnia deposits and domestic government debt securities have continued to exceed both current inflation and the inflation rate expected by households. As a result, household demand for bank deposits with maturities from three to 12 months and domestic government debt securities has continued to rise.

Maintaining relatively high yields on hryvnia instruments is important for the continued implementation of the Strategy for Easing FX restrictions, Transitioning to a More Flexible Exchange Rate and Returning to Inflation Targeting.

However, given the high sensitivity of the FX market and a substantial surplus of hryvnia liquidity, more rapid cuts in the key policy rate would increase risks to exchange rate stability and the steady decline in inflation.

In view of that, starting in 15 September 2023, the NBU Board decided to cut the key policy rate by 2 pp, to 20%, which is in line with the trajectory of the July forecast.

The interest rate on three-month certificates of deposit will continue to equal the key policy rate. Meanwhile, the NBU Board cut the interest rate on overnight certificates of deposit by 2 pp, to 16%, and that on refinancing loans by 2 pp, to 22%.

The controlled easing of interest rate policy will provide additional impetus to the economic recovery, without threatening macrofinancial stability during the implementation of the Strategy for Easing FX Restrictions.

What is more, the NBU will adjust the parameters of the operational design of its monetary policy. More specifically, the NBU will decrease, to 35%, the share of existing household term deposit balances which are used to calculate the limits on the banks' purchases of three-month certificates of deposit.

This will further encourage the banks to compete for depositors, and to expand their term deposit portfolios. These changes will come into effect from 18 September.

Looking ahead, the NBU plans to continue its key policy rate cutting cycle. The central bank will do this, while balancing the cuts against the need to maintain the attractiveness of hryvnia assets, which is key to a sustainable FX market and a steady decline in inflation.

That said, given great uncertainty and high war-related risks, the NBU will act cautiously, so as to be able to safeguard macrofinancial stability in future.

If expectations deteriorate, the attractiveness of hryvnia instruments declines noticeably, and risks to exchange rate stability increase, the NBU will adjust its decisions and key policy rate forecast accordingly.

Thank you for your attention!