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 March 2024.

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Dear colleagues,

The Board of the National Bank of Ukraine has decided to cut the key policy rate to 14.5% effective 15 March 2024. A further decline in inflation, sustained stable FX market conditions, and positive developments in the prospects to receive external assistance lay ground for an earlier resumption of the easing cycle of interest rate policy.

At the start of 2024, inflation slowed more rapidly than expected by the NBU

In February, inflation decelerated to 4.3% yoy. Among other things, this was facilitated by higher supply of some food products and effects from last year's strong harvests. The reorientation of some producers to the domestic market also had an impact on food prices. In addition, the moratorium on raising some utility prices continued to restrain inflation.

Core inflation decelerated as well, to 4.5% yoy. Stable FX market conditions – among other things, owing to the NBU's monetary policy and currency supervision measures – improved inflation and exchange rate expectations across the majority of respondent groups. This reined in underlying price pressures. The official and cash exchange rates became almost equal, and the hryvnia exchange rate fluctuated moderately in both directions, which was in line with the managed exchange rate flexibility.

Since the previous monetary decision taken in January, market rates on hryvnia instruments have not changed much. Yields on bank deposits and domestic government debt securities continued to exceed inflation expectations of businesses and households. Together with the controlled situation on the FX market, this supported interest in domestic currency savings. In particular, Ukrainians' holdings of domestic government debt securities increased, and retail deposits placed for three months and longer showed steady growth.

Inflation will remain moderate, in particular thanks to the NBU's consistent monetary policy

The NBU estimates inflation will remain within the target range of 5% ± 1 pp in the coming months and will accelerate only moderately in H2. A gradual increase in incomes of Ukrainians and higher business costs during the war will fuel the inflationary pressure.

At the same time, some utility tariffs being frozen and the NBU's monetary policy aimed at supporting the attractiveness of hryvnia assets and exchange rate sustainability will continue to curb growth in consumer prices.

The course of the full-scale war continues to be the key risk to inflation dynamics and economic development

The NBU's January macroeconomic forecast was based on the assumption that the security situation would improve significantly from 2025. However, the risk of protracted Russian aggression against Ukraine still exists. The protracted war would slow economic recovery and make it more difficult for the NBU to keep inflation close to the 5% target in 2025–2026.

The risk of insufficient inflows of international financing also persists. That said, positive developments have been seen recently in this respect.

At the end of February, the Council of the European Union approved the launch of Ukraine Facility instrument to the total amount of EUR 50 billion for 2024–2027. Under this instrument, Ukraine should receive EUR 4.5 billion of bridge financing already in March.

Ukraine has also reached the staff-level agreement on the third review of the program with the International Monetary Fund and expects to receive the decision of the IMF Executive Board in a week.

Overall, the country might receive more than USD 10 billion in March–April. A pickup in external assistance inflows in the near future will allow Ukraine to significantly increase its international reserves.

In addition, the following risks remain relevant:

- the emergence of additional budget needs to maintain defense capabilities or cover substantial quasi-fiscal deficits, in the energy sector in particular
- significant damage to infrastructure, especially port infrastructure, which will limit exports
- the continuation of the partial blockade of freight transportation at border crossings with some countries, which will reduce exports and make imports more expensive
- the deepening of adverse trends in migration.

On the other hand, positive scenarios could also materialize. Thus, a significant expansion of the capacity of the maritime corridor could help Ukraine's exports recover faster, and given the enhanced effectiveness of currency supervision measures, increase foreign exchange earnings.

The implementation of large-scale reconstruction projects in Ukraine could give considerable impetus to economic recovery. Discussions have also recently intensified about the use of immobilized Russian assets in Ukraine's favor. The implementation of these initiatives could significantly improve key macroeconomic indicators.

Taking into account the further deceleration of inflation and a steady improvement in expectations, a stable FX market, and a partial reduction in the risks associated with obtaining international assistance, the NBU Board decided to cut the key policy rate by 0.5 percentage points, to 14.5%.

The easing of interest rate policy will support economic recovery, without threatening macrofinancial stability. The new level of interest rates on the NBU's operations is sufficient to maintain the attractiveness of hryvnia assets, safeguard exchange rate sustainability and retain moderate inflation.

In particular, for these purposes, the NBU plans to continue operations with three-month certificates of deposit as an effective element of the operational design of interest rate policy, which has proven to be effective over the past year. At the same time, in the context of the interest rate policy easing cycle and a steady slowdown in inflation, the need for a significant difference between the interest rate on this operation and the key policy rate is diminishing.

In view of the above, the NBU is cutting the interest rate on three-month certificates of deposit by 1.5 percentage points, to 17.5%. What is more, the NBU is decreasing the interest rate on refinancing loans by 1.5 percentage points, to 19.5%. The interest rate on overnight certificates of deposit will continue to equal the key policy rate.

If required, the NBU will continue to modify the parameters of operations with three-month certificates of deposit. In particular, starting from 19 April, to determine the limit on banks' investments in three-month certificates of deposit, the growth of hryvnia household deposits with a maturity of more than 93 days will be calculated for the last 12 months (rather than from 4 April 2023, as is currently the case).

This will encourage banks to increase their portfolios of hryvnia household term deposits, which is important for maintaining exchange rate sustainability and protecting international reserves.

The NBU will continue the cycle of interest rate policy easing, provided that risks to inflation and exchange rate sustainability are sustainably reduced

The NBU continues to be prepared to adapt its interest rate policy dynamically in response to changes in the balance of risks to inflation and exchange rate sustainability.

Maintaining a controlled situation in the FX market and moderate inflation, as well as increased foreign aid inflows, will create preconditions for further steps to cut the key policy rate and ease FX restrictions. They will promote lending and support economic recovery.