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, 25 April 2024.

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Dear colleagues,

The Board of the National Bank of Ukraine has decided to cut the key policy rate from 14.5% to 13.5% effective 26 April 2024. Considering a decline in actual and expected price pressures and lower risks to inflows of international financial support, the NBU continues the easing cycle of its interest rate policy.

This will support lending development and economic recovery without posing additional risks to price and financial stability.

In Q1 2024, consumer inflation slowed more rapidly than expected by the NBU

Actual consumer inflation slowed to 3.2% yoy in March and was below the NBU's forecast. The deviations from the forecast were primarily driven by temporary factors that were difficult to predict. Mild winter led to higher supply of raw foods and lowered the pressure on business costs, in particular the cost of energy. In addition, effects of last year's strong harvests continued.

Core inflation also slowed (to 4.2% yoy) but was rather close to the NBU's forecast. On the one hand, further growth in labor costs and consequences of the blockade of the western borders supported underlying inflationary pressures. On the other hand, the underlying inflationary pressures were eased by an improvement in inflation expectations and pass-through effects from lower prices of raw foods to the prices of processed foods and some services.

The NBU has improved its inflation forecast for 2024 to 8.2% and expects inflation to settle within the target range of 5% ± 1 pp in the coming years

As before, the NBU forecasts a moderate increase in inflationary pressure in view of the expected vanishing of effects from last year's strong harvests, continued recovery in consumption, and a rise in business costs amid the war. At the same time, taking into account the improved dynamics of actual inflation and better inflation expectations, the NBU has lowered its end-2024 inflation forecast, from 8.6% to 8.2%.

In the coming years, inflation will return to the target range of 5% ± 1 pp and will settle at this level. This will be facilitated by a gradual normalization of conditions in which the economy functions, an easing of external inflationary pressures, and the NBU's consistent monetary policy. Inflation is expected to slow to 6% at the end of 2025 and to 5% at the end of 2026.

The economic recovery will continue, but will be restrained – primarily, due to significant damage to energy infrastructure

According to the NBU's estimates, real GDP growth in Q1 2024 was weaker than expected, mainly as a result of limited budgetary spending amid the uncertainty about inflows of external financing. The blockade of the western borders was an additional factor restraining the activity in some economic sectors. At the same time, the operation of the sea corridor, favorable weather, and an increase in domestic demand supported economic growth.

The NBU forecasts further recovery in economic activity in the wake of recent developments in the issue of receiving international assistance and an expected pickup in domestic and foreign demand. At the same time, the real GDP growth forecast has deteriorated due to the consequences of Russia's attacks on Ukraine's energy infrastructure. The economy is expected to grow by 3% in 2024 and by 4.5%–5% in 2025 and 2026.

The continuation of international financial support and measures to strengthen the resilience of public finances will secure further macrofinancial stability necessary for sustainable economic recovery

As expected, Ukraine received USD 9 billion from international partners in March, which allowed the country to increase its international reserves to almost USD 44 billion. Moreover, in the past days, Ukraine received positive news from the United States about the approval of the military and financial assistance package. Ukraine also received another tranche from the EU in the amount of EUR 1.5 billion. In such a way, Ukraine can count on receiving USD 38 billion in external budgetary support this year.

In the meantime, the country continues to implement measures to increase its self-sufficiency. The government is strengthening its own resource base and increasing borrowing from the domestic market. For its part, the NBU is improving currency control measures. Combined with the resumed regular inflows of external assistance, this will allow financing the planned budget expenditures and supporting the controllable situation on the FX market.

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

Russia's aggression continues and causes new losses to the Ukrainian economy. The NBU assumes that security risks will subside and that economic conditions will normalize over the forecast horizon. However, a prolonged, high-intensity war threatens to further destroy cities, infrastructure, and production facilities, and the extent of the destruction is difficult to estimate in advance.

Compared to the previous forecast, the risk of insufficient international financing this year has eased considerably, but the risks to regular financing remain. The following risks also remain significant:

- the emergence of additional budget needs to maintain defense capabilities or cover substantial quasi-fiscal deficits, in the energy sector in particular
- heavy damage to infrastructure, especially energy and port infrastructure, which will limit economic activity and put supply-side pressures on prices
- the continuation of the partial blockade of freight transportation at border crossings with some EU countries, which will depress exports and make imports more expensive
- the deepening of adverse trends in migration, and
- the aggravation of the situation in the Middle East, which, in particular, increases the risks of possible disruptions to energy supplies and a rise in energy prices for the global economy.

At the same time, a number of positive scenarios may still materialize, including further expansion of export opportunities, the transfer of funds from immobilized Russian assets to Ukraine, the acceleration of European integration processes, and the implementation of a large-scale recovery program.

Taking into account the balance of risks, as well as favorable macrofinancial trends, in particular better inflation dynamics, the NBU Board decided to cut the key policy rate by 1 pp, to 13.5%.

The previous steps to ease interest rate policy and changes in the operational design of monetary policy gradually decreased nominal yields on hryvnia deposits and domestic government debt securities. At the same time, on the back of the overall improvement in inflation expectations, these instruments remained attractive and in demand. A moderate cut in the key policy rate should not diminish interest in hryvnia assets, as they will continue to protect savings from being eroded away by inflation.

The NBU is also cutting the interest rates on overnight certificates of deposit and three-month certificates of deposit, to 13.5% and 16.5% respectively. What is more, the NBU is decreasing the interest rate on refinancing loans more pronouncedly – by 2 pp, to 17.5%. In the context of the interest rate policy easing cycle, the need to maintain a significant difference between the interest rate on refinancing loans and the key policy rate is diminishing.

With the level of international reserves being sufficient, the situation on the FX market being under control, and there being expectations of further international assistance inflows, the NBU is preparing a number of steps to liberalize the FX market in the coming weeks. These steps will be in line with the Strategy for Easing FX Restrictions, Transitioning to a More Flexible Exchange Rate, and Returning to Inflation Targeting. These steps have already been taken into account in the revised macroeconomic forecast, which assumes that international reserves will remain close to their current level this year and next year.

The NBU sees some room for the further easing of its interest rate policy, provided that favorable macrofinancial trends continue

The baseline scenario of the NBU's forecast envisages a cut in the key policy rate to 13% this year. This easing of interest rate policy and the planned steps to liberalize the FX market should not pose any additional threats to macrofinancial stability and FX market resilience.

At the same time, the NBU will adapt its monetary policy if the balance of risks changes significantly. Thus, lower risks to inflation and exchange rate sustainability could create preconditions for further cuts in the key policy rate and an easing of FX restrictions, which would support lending and economic recovery.