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, 19 September 2024.

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Dear colleagues,

The Board of the National Bank of Ukraine has decided to keep its key policy rate at 13%. This decision will help gradually bring inflation back to the target of 5% in the coming years and support the sustainability of the FX market.

Inflation has expectedly accelerated in recent months

In August, consumer inflation rose to 7.5% in annual terms, which was close to the forecast the NBU made in July. The underlying inflationary pressure, measured by core inflation, also increased to 6.5%.

The growth in consumer prices was driven by the impact of lower harvests, businesses' larger expenses, and the effects of the weakening of the hryvnia in the previous months. However, inflation expectations remained rather sustainable.

The pressure on prices will persist in the near future, but inflation will slow next year

Inflation will rise moderately in the coming months due to an increase in aggregate demand against the backdrop of budgetary spending, businesses' larger expenses on wages and electricity, and higher excise taxes.

However, the NBU's prudent monetary policy and lower external price pressures will contribute to a gradual decline in inflation and its return to the target of 5% in the coming years. To meet the target, the NBU will, in particular, maintain a manageable situation on the FX market.

International reserves are being kept on a level sufficient for ensuring the sustainability of the FX market

In August, Ukraine received a large amount of international financial assistance. At the same time, the NBU's interventions to sell foreign currency declined substantially on the back of a decrease in net demand from businesses and households. As a result, Ukraine's international reserves exceeded USD 42 billion as of the start of September.

The staff level agreement on the fifth review of the IMF program reached in September was another positive signal that volumes of international assistance will continue to be sufficient and macrofinancial resilience will be maintained.

Considering the above and the sufficient set of available instruments, the NBU will remain fully capable of supporting the sustainability of the FX market, prevent excessive exchange rate fluctuations, and ensure that the exchange rate moves both ways.

International financial support and measures to mobilize internal resources should help the government finance the budget deficit without resorting to monetary financing

The war is grinding on. The russian aggression continues to put significant pressure on public finances. Given the need for large expenses on defense capability, budget expenditures for 2024 have been raised considerably. The draft state budget for 2025 envisages that expenditures will remain high – the budget deficit will exceed 19% of GDP.

The budget expenditures are planned to be financed on account of further increases in budget revenues, financial support from international partners, and more domestic borrowing though selling domestic government debt securities, made possible thanks to efforts of the government with the NBU's assistance. This will enable the country to mobilize necessary resources and avoid returning to monetary financing over the forecast horizon.

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

The time needed for inflation to return to the 5% target and the sustainability of Ukraine's economic development will strongly depend on the nature and duration of the war.

The russian aggression continues to generate the following risks:

- the emergence of additional budget needs, mainly those to maintain defense capabilities
- the likelihood of an additional hike in taxes, which – depending on its parameters – might spur the pressure on prices
- further damage to infrastructure, especially energy and port infrastructure, which will limit economic activity and put supply-side pressures on prices
- a deepening of adverse migration trends and further widening of labor shortages on the domestic labor market.

The uncertainty also persists over the volumes of international partners' further support for Ukraine. Among other things, this is due to many countries being focused on their internal election cycles and russia making sabotage attempts in other countries and at the level of international institutions.

At the same time, a number of positive scenarios might also materialize in relation to large inflows of funds to Ukraine coming from frozen russian assets. These scenarios may also be related to a further expansion of export opportunities, the acceleration of European integration processes, and a faster pace of repairs in the energy sector.

Taking into account the balance of risks, the need to bring inflation back to its 5% target in the coming years, and to ensure the sustainability of the FX market, the NBU Board decided to keep the key policy rate at 13%

In recent months, interest rates on hryvnia instruments have been declining, reflecting the impact of previous monetary easing measures. However, the yields on hryvnia deposits and domestic government debt securities remain sufficient to protect hryvnia savings from being eroded away by inflation. The latter remains one of the important tasks for the NBU.

In July, the NBU suspended its interest rate easing to maintain an appropriate level of yields on hryvnia instruments. The central bank currently believes it expedient not to resume the cycle of key policy rate cuts. The September's decision to keep the key policy rate at 13% aims to maintain interest in hryvnia savings and to restrain demand on the FX market.

The NBU Board also decided to change the parameters of other monetary policy instruments and operations

More specifically, from 20 September 2024, interest rate on three-month certificates of deposit will be cut to 15.5%. Interest rate on refinancing loans will be also decreased, to 16%, while the maximum loan term will be limited to two weeks. Interest rate on overnight certificates of deposit will continue to equal the key policy rate.

At the same time, from 11 October 2024, the NBU will raise its reserve requirement ratios by 5 pp (excluding term hryvnia household deposits with maturities of more than 93 calendar days). Moreover, from that day, the NBU will also increase, to 60%, the share of required reserves the banks can meet using benchmark domestic government debt securities.

The NBU believes that these steps will not pose any risks to the sustainability of the FX market and the return of inflation to its target over the policy horizon. Instead, the combination of these measures will increase the flexibility of banks in managing their liquidity and stimulate additional demand for domestic government debt securities. This will strengthen the government's ability to raise the necessary funding on the domestic debt market.

The NBU will continue to flexibly adapt its monetary policy if macroeconomic indicators deviate from expectations and if the balance of risks to inflation, the FX market's sustainability, and economic development changes significantly.

Thank you for your attention!

Glory to Ukraine!