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, 31 October 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%. Coupled with maintaining the sustainability of the FX market, this decision will allow keeping inflation expectations under control, slow down inflation next year, and bring it back to the 5% target going forward.

As expected, inflation has increased in recent months. However, the pace of the increase was somewhat faster than forecast

In September, inflation accelerated to 8.6% yoy, and continued to rise in October, according to the NBU's estimates. The increase in the price pressure in H2 2024 was expected, being reflected in the NBU's previous forecasts. At the same time, the growth in both consumer and core inflation was faster than forecast.

An important contribution to these dynamics came from an increase in food prices on the back of smaller-than-expected harvests of various crops, and from the related growth in the cost of food industry inputs. The rise in inflation was also driven by further increases in production costs, including the costs of electricity and labor, as well as by exchange rate effects from the weakening of the hryvnia in previous periods.

Despite the acceleration of inflation in recent months, economic agents' inflationary expectations remained sufficiently stable and controllable, albeit worsening marginally.

The pressure on prices will persist in the coming months, but inflation will start to slow in spring 2025

In the coming months, the pressure on prices will persist due to the further impact of food supply factors, increases in budget expenditures, rapid wage growth, and wider energy shortages during the heating season. As a result, inflation will hit 9.7% at the end of 2024.

That said, inflation will start to decline in spring 2025. The slower price growth next year will be driven by the NBU's prudent monetary policy and weaker external price pressures, as well as by an improvement in the energy sector and an increase in harvests. The NBU forecasts inflation to decline to 6.9% at the end of 2025 and return to the 5% target in 2026.

The economy continues to grow, although the growth remains limited due to the war

The waves of Russia's attacks on the energy infrastructure, an increase in migration, and labor shortages slowed the economic recovery. However, real GDP kept growing, in both Q2 and Q3 2024. That said, smaller shortages of electricity and somewhat larger harvests of early grain crops enabled the NBU to revise its forecast for real GDP growth in 2024 upward, to 4%.

Significant budget stimuli, backed by large volumes of international financing, rising household income, growing outputs in crop farming, and sustained external demand will support further growth in the Ukrainian economy, at 4.3%–4.6% in 2025–2026.

The uncertainty about volumes of international assistance decreased. Sufficient inflows of external support will allow the government to continue financing large budget expenditures and enable the NBU to maintain the sustainability of the FX market

In October, the IMF disbursed another tranche to Ukraine in the amount of USD 1.1 billion as a result of the fifth review of the Extended Fund Facility. Around USD 300 million of concessional financing came from Canada.

By the end of the year, Ukraine is expected to receive more than USD 15 billion, of which USD 4.8 billion under the World Bank's SPUR program supported by financing from the United States.

In addition, considerable progress was made in confirming future volumes of assistance. International partners came much closer to the disbursement to Ukraine of a non-repayable loan secured by proceeds from frozen Russian assets, to the total amount of USD 50 billion, as part of the ERA mechanism.

Therefore, international support for Ukraine will remain significant. Taking into account the expected inflows, the NBU has improved its assumptions about external financial support for 2024–2026. The total amount of international financing is expected to reach USD 41.5 billion this year and USD 38.4 billion next year.

The continued external support, together with sufficient volumes of borrowing from the domestic market, will enable the government to keep covering the large budget deficit without resorting to monetary financing.

For its part, the NBU will be able to maintain an adequate level of international reserves to preserve the sustainability of the FX market. The projections for these reserves have been revised upward compared to the July forecast – to USD 43.6 billion for 2024, and to USD 41 billion for 2025.

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

The war continues. Accordingly, the risks of a further decline in economic potential remain, in particular due to the loss of people, territories, and production facilities. The speed of the economy's return to normal will depend on the nature and duration of the war.

What is more, it 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 – may drive up pressures on prices
- further damage to infrastructure, especially energy and port infrastructure, which will restrain economic activity and put supply-side pressures on prices
- a deepening of adverse migration trends and a further widening of labor shortages on the domestic labor market.

There is also a risk of increased geopolitical tensions in the world amid the war in the Middle East, the electoral cycles in some countries, and Russia's attempts to form a coalition of states.

At the same time, a number of positive scenarios are still likely to materialize, resulting from further acceleration of European integration processes and recovery in the energy sector.

In order to maintain the sustainability of the FX market, bring inflation back to its target over the coming years, and keep inflation expectations in check, the NBU Board decided to keep the key policy rate at 13% per annum

Given that inflation has not yet peaked, and that pro-inflationary risks have even increased for the coming months, the NBU believes it appropriate to remain cautious while conducting its interest rate policy, and to take prudent measures to safeguard the sustainability of the FX market.

To counteract price pressures, the NBU suspended its interest rate policy easing cycle in July. This has supported interest in hryvnia savings, the interest rates of which currently provide adequate protection against inflationary depreciation. In particular, the inflow of households' hryvnia term deposits resumed in the fall, and investments in domestic government debt securities continued to grow.

The policy of protecting hryvnia savings from being eroded away by inflation will continue to help limit pressures on the FX market and preserve international reserves. Using the regime of the managed flexibility of the exchange rate, the NBU will compensate for the structural shortage of foreign currency in the private sector and smooth out excessive exchange rate fluctuations.

The exchange rate will fluctuate moderately in both directions in response to changing market conditions, which will further strengthen the adaptability of the FX market and the economy. Exchange rate movements will be in line with the NBU's objectives of keeping inflation expectations under control, slowing inflation next year, and returning it to its 5% target on the policy horizon.

If pro-inflationary risks continue to materialize, the NBU stands ready to deploy all available monetary policy tools

The revised NBU forecast envisages keeping the key policy rate at 13% for a longer period – at least until the summer of 2025. In the event that price pressures continue to rise above the forecast and threaten to unanchor inflation expectations, the NBU will be ready to tighten its interest rate policy and take additional monetary measures.

Thank you for your attention!