Andriy Pyshnyy: Speech - Workshop on monetary policy in emerging markets

Speech by Mr Andriy Pyshnyy, Governor of the National Bank of Ukraine, at the NBU-EABCN Workshop on Monetary Policy in Emerging Markets, Kyiv, 4 December 2024.

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Dear colleagues,

I am delighted to welcome you to this workshop dedicated to monetary policy in emerging markets!

Every year, this event brings together leading experts from central banks, international financial institutions, and think tanks. As ever, it provides we professionals with a chance to mull over the most pressing challenges facing us, and to discuss the policy responses that we can use to meet these challenges.

The topic of the workshop is highly relevant and at the same time extremely complex – requiring as it does the crafting of integrated and consolidated solutions. We must discover not only how to respond adroitly to rapidly changing conditions, but also how to effectively shape these conditions in our favor.

The world today is not what it was yesterday. Tomorrow it will change again. But at all times we have a duty to pursue our mandate. Moreover, fulfilling our mandate is becoming increasingly important in these uncertain times, as one of a central bank's functions is to reduce uncertainty.

The Russian invasion of Ukraine was an inflection point at which a new reality began. Not only did the war pose a tremendous challenge to our country, it also triggered tectonic shifts in the global socio-economic landscape. The shockwaves have spread far beyond Ukraine, causing disruption to global supply chains, energy crises, and the imposition of sanctions. Significant uncertainty is the new economic normal.

In Ukraine, the war challenged us to take quick, bold decisions. As I have repeatedly said, there is no textbook in the world that answers the question, "How do you conduct your monetary policy when your country is being attacked by a state with a much larger economy?" In fact, we are adding chapters to textbooks even as the war grinds on, through our actions to counteract inflationary and depreciation pressures in the face of subdued investment activity, unprecedented migration, and structural changes in the economy.

Not just Ukraine, but all countries are facing the challenges and consequences of uncertainty – emerging markets are no exception. Striking a balance between short-term emergency measures and strategic goals is a task that faces us all.

The purpose of our workshop is to discuss integrated solutions that match the complex nature of our modern challenges.

And so let me start out by outlining three key challenges facing central banks.

The first is the aforementioned heightening of uncertainty. Russia's war against Ukraine, the unstable geopolitical situation, and global economic shocks are fueling sharp energy price fluctuations, supply chain disruptions, FX market pressures, and significant capital mobility. All of these require effective and strategic responses from central banks.

The second key challenge comes in the form of the pressures on our financial systems. These include a growing debt burden, increased risks to the banking system, and capital outflows – and, again, all are significant threats to emerging markets. Monetary policy must therefore continue to be flexible, but consistent in its aim to retain its credibility with businesses and households.

The third key challenge is the limited effectiveness of conventional policy instruments. Traditional approaches to policy implementation are inadequate for today's unprecedented challenges. Strong supply-side shocks, when they materialize, expose this deficiency of monetary policy, as its capacity to affect them is limited.

For this reason, emerging markets are particularly affected by the policies pursued by developed countries, which in turn raises even greater obstacles to conducting an effective independent monetary policy to ensure macroeconomic and financial stability.

How should we respond to these challenges?

We at the NBU have no silver bullets, but we do have experience to share. I will outline the stages through which Ukraine's monetary policy has evolved amid the war. I hope this adds an important element to the discussions and provides inspiration.

In the earliest months of Russia's invasion, the NBU was forced to take stringent anti-crisis measures. These included an exchange rate peg, FX restrictions, and financing the government. All this was done to minimize panic and keep the economy afloat.

But the NBU quickly realized that these were not sustainable, long-term solutions. So, as soon as the initial shocks of the war subsided, and the proper prerequisites were in place, the NBU began to move back towards a more balanced and predictable policy. First, we introduced a set of measures to enhance the impact of the key policy rate. This was done by modifying reserve requirements and the operational design of interest rate policy.

When more prerequisites were met, we switched to a policy of managed flexibility of the exchange rate. And in 2024, we were able to introduce flexible inflation targeting as an intermediate monetary regime.

Using this approach, the NBU is pursuing the policy of steering inflation to a point target of 5% within an extended policy horizon of up to three years. Inflation targeting reduces uncertainty, while flexibility allows us to take current economic conditions into account – including structural shocks caused by the war.

Flexible inflation targeting has its own distinct features.

First, we focus on long-term goals. Even in crisis conditions, we adhere to inflation benchmarks, paving the way for a gradual return to full-fledged inflation targeting.

Second, our monetary policy reacts to the conditions of the day: We have a broader monetary policy horizon under the transitional regime, which allows us to quickly adapt and respond to new shocks, such as energy crises or supply chain disruptions.

Third, flexible inflation targeting involves the use of a combination of instruments. Apart from interest rate policy, we maintain an active presence in the FX market and impose caps on capital movements. As favorable prerequisites emerge, however, we continue our movement towards more market-based mechanisms.

We will give special attention today to this third feature, as the use of a combination of policy instruments is not unique to Ukraine and is increasingly seen in other small open economies. In fact, the main task of this workshop is to find an effective balance between the instruments used – in particular those based on advanced macroeconomic analysis.

The fourth important feature of a flexible monetary regime is a high level of interaction between the fiscal and monetary authorities. The NBU cooperates closely with the government in raising external financing and implementing reforms in Ukraine. At the same time, this cooperation implies that authorities must respect each other's mandates.

Which brings us to the fifth feature: The NBU strives for transparent, active communications with every target audience. We freely explain our decisions to avoid misleading market participants, experts, government officials, investors, and the public. We do this to maintain their trust – the primary anchor for an effective policy.

Through this approach, Ukraine has been able to retain macrofinancial stability while setting the stage for economic recovery, despite continuing to face massive challenges.

In addition to internal transformation, an important component of resilience is close cooperation with international partners.

For Ukraine, cooperation is now an integral element of macrofinancial stability. And at this point I'd like to reiterate our gratitude to our partners for the expert, financial, military, and humanitarian assistance they have provided.

Today we are one thousand and fifteen days into the war. In the first hours of the invasion, and further on, the NBU received overwhelming support from central banks and international organizations and institutions.

The unprecedented support we have obtained from the International Monetary Fund, the World Bank, the European Union, and the United States has been truly invaluable, and has enabled Ukraine not only to confront the consequences of the war, but also to look ahead and plan for long-term recovery.

We took full advantage of this help, and now that we are on the path to recovery, we are actively exchanging our experience with our colleagues from other countries, via events such as this workshop. Sharing knowledge is also a powerful resource, and, we are excited to share our expertise with you while continuing to refine our approaches.

The challenges facing us may differ, but we all share a common goal – to create a sustainable economy capable of ensuring the stable development of countries.

I believe that integrated approaches, the exchange of experience, and international cooperation are key elements for success in this endeavor.

Today we will review cutting-edge research into topics such as FX interventions, capital controls, international reserves, and the interaction between fiscal and monetary policies.

We will be honored to hear a report from leading IMF economists Jesper Lindé and Marcin Kolasa on the Integrated Policy Framework. I'm confident that their presentation will set the foundation for fruitful discussions on the practical aspects of an integrated approach.

Another highlight of today's workshop will be a presentation of the IMF's extended Quarterly Projection Model, or QPM. Following the QPM presentation, we will hold a panel discussion with leading industry experts, chaired by Natan Epstein of the IMF, about the specifics of implementing an integrated approach in our core macro models. This is of great practical importance to us, as we have been working closely with the IMF team to improve our own modeling toolkit.

I hope that today's event will be a source of new ideas and solutions for us all. Thank you for your attention, and I wish you productive discussions!

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