

Monetary and FX policy: How NBU is preparing to deal with 2025 macroeconomic challenges

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XIII Conference Market|Risk|2024

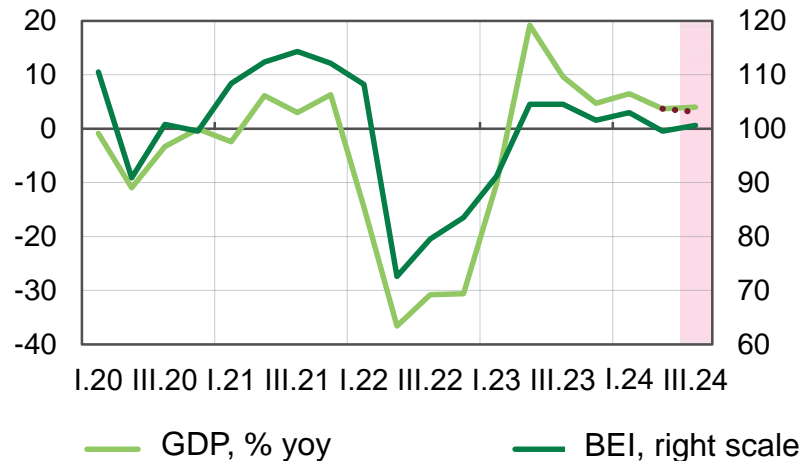
Kyiv, Ukraine

7 November, 2024

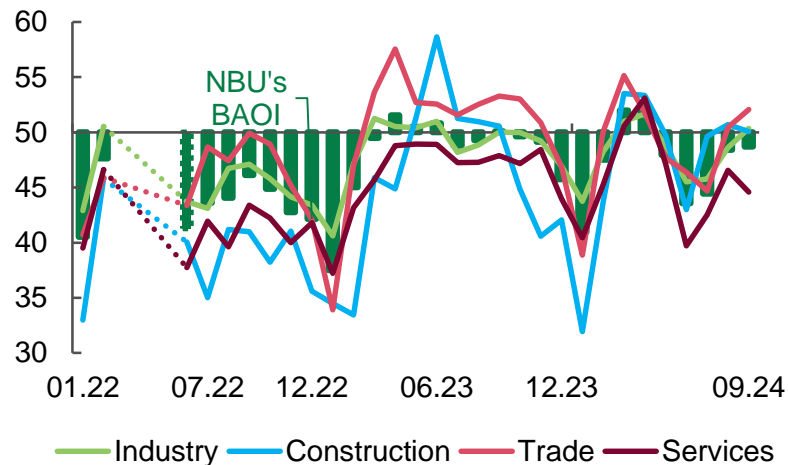


Economic activity remains resilient due to a relatively stable energy supply, sea corridor functioning, and early harvesting

GDP and Business Expectations Index (BEI)



NBU's Business Activity Outlook Index, p



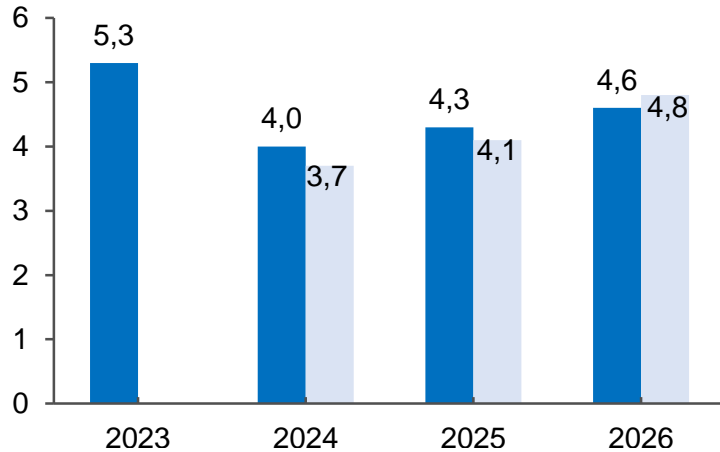
Source: Ukrstat, NBU.

A level above 50 indicates predominantly positive expectations. Survey was not conducted from March to May 2022. Source: NBU.

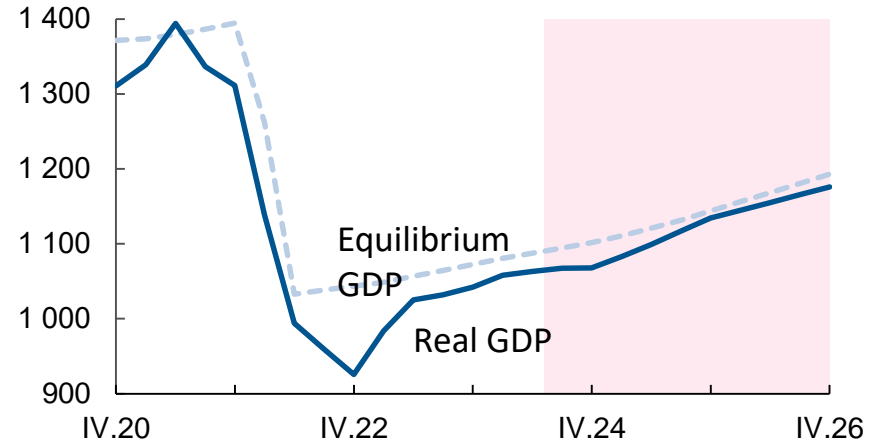
- **In September economic activity continued to pick up amid relatively stable energy supply**, which influenced further improvement of business expectations. Consumer demand remained steady despite a slight deterioration in consumer sentiment
- **Harvesting of late crops continues at a much faster pace than last year**. However, their yield and quality are lower than last year because of the drought
- **The stable functioning of the sea corridor supported the continued growth of transportation** and together with the state financing of weapon production projects supported industry

GDP growth will accelerate and GDP will nearly reach equilibrium level in 2026

Real GDP, %



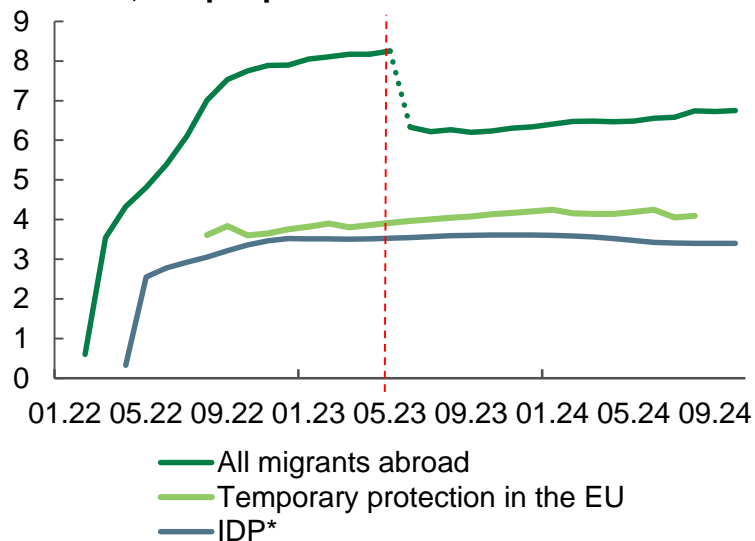
Real GDP and equilibrium (in logs)



- **The economy is recovering faster than expected** due to larger external support, higher yields of early grain crops, lower electricity shortages and faster adaptation of businesses to electricity outages.
- **Economic growth will pick up.** In 2025 due to still loose fiscal policy, rising household incomes and robust external demand. In 2026 - thanks to the reduction of the energy deficit, the reduction of security risks, the growth of the harvest, the acceleration of consumer and investment activity
- **Risks:** war effects, labor market, energy shortage ↑

Labor market remains tight amid high migration and mobilization. Labor shortages support the wage growth

Estimates of the number of Ukrainian migrants abroad*, mn people



*In June 2023, the UNHCR revised its approach to estimating the number of Ukrainian migrants, the estimates declined.
Source: UNHCR.

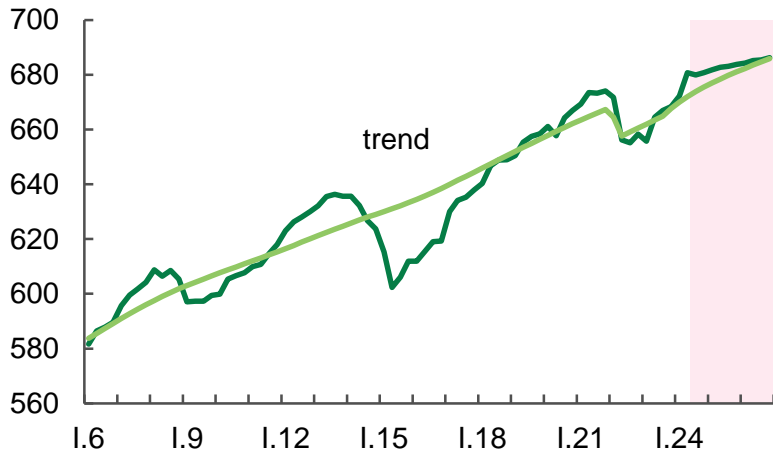
Index for difficulty of finding new employees*



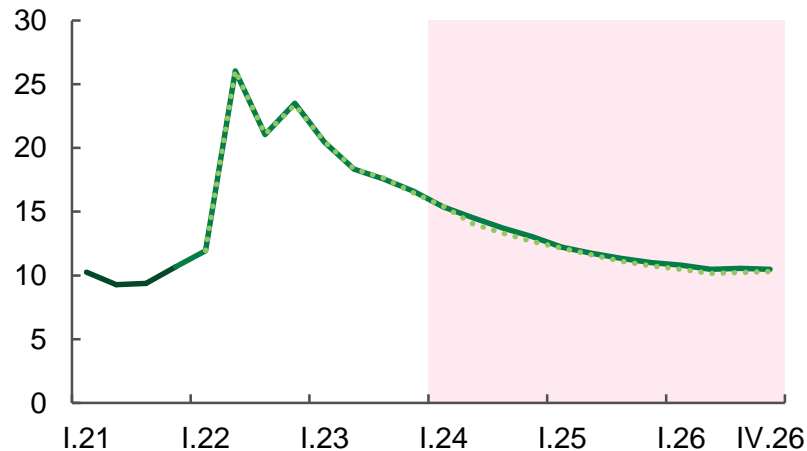
* Difference between the shares of answers: "finding employees has become more difficult" and "finding employees has become easier".
Source: IER.

High wage growth rates due to economic recovery and a shortage of qualified personnel are fueling inflation

Real wages, level (logarithms)



Unemployment (ILO), %, sa



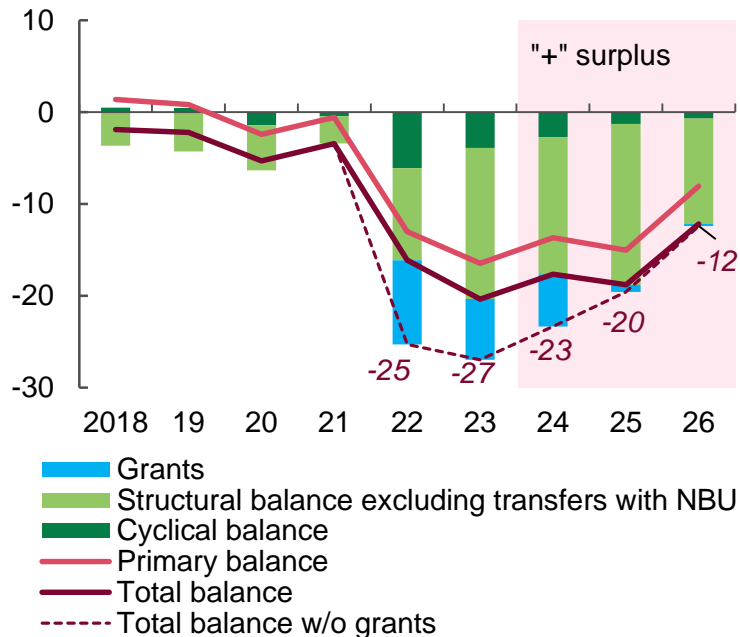
- **Imbalances in the labor market will persist:** there are difficulties in finding qualified workers, so unemployment is declining slowly. The shortage of workers will hold back the recovery of the economy. At the same time, it will stimulate the further growth of salaries at high rates
- **The security situation will deter the return of migrants,** which will limit the recovery in the labor market

Change, %	2023	2024	2025	2026
Real Wages	3.7	14.0 (9.7)	6.5 (5.8)	2.9 (2.9)

%	2023	2024	2025	2026
Unemployment	18.2	14.2 (13.9)	11.6 (11.4)	10.6 (10.3)

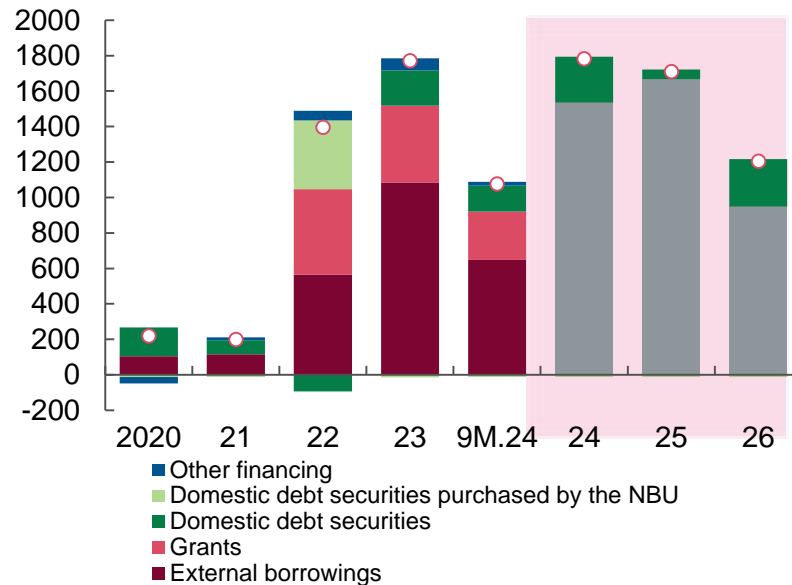
Budget deficits will remain significant, with raised taxes going to war expenses. Other needs will be covered mainly by international aid

Consolidated budget balance, % of GDP



Source: STSU, SSSU, NBU staff estimates.

Sources of financing the budget deficit, bn UAH

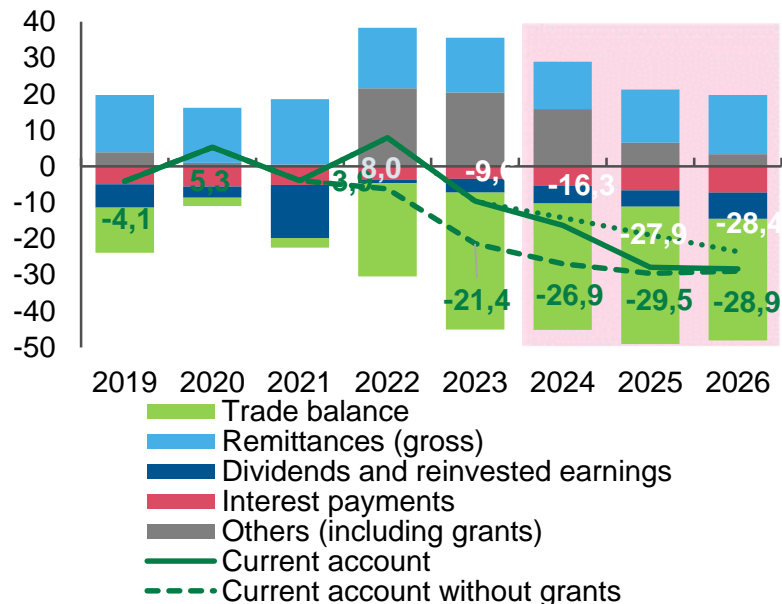


Source: STSU, NBU staff estimates.

* Net borrowing. Hryvnia-denominated borrowings include domestic debt securities issued to increase the authorized capital of banks, the Deposit Guarantee Fund (DGF), and other state-owned enterprises. Deficit in 2024–2026 reflects the NBU's forecast. The grey color denotes external borrowings, grant funds, and other financing, in particular, the use of relatively large cash balances on gov't accounts at the end of the previous period.

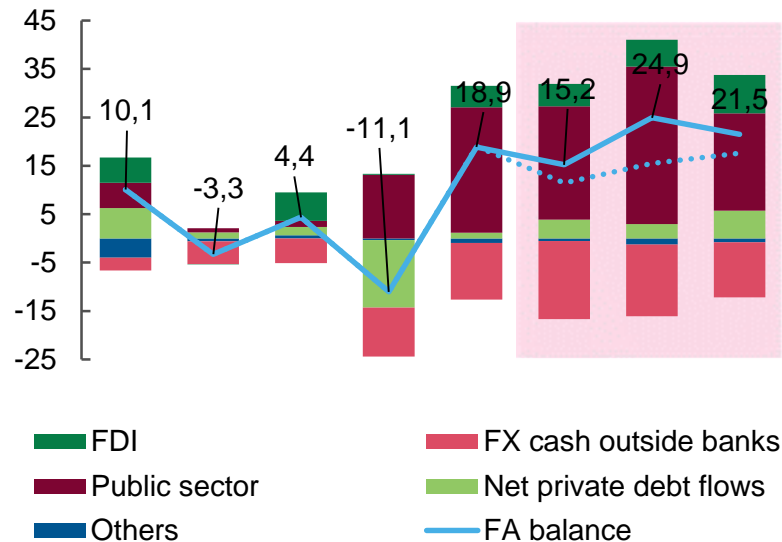
Trade deficits will remain significant due to the high demand for imported goods. Official financing will remain the main source of inflows

Current account, bn USD



Source: NBU staff estimates.

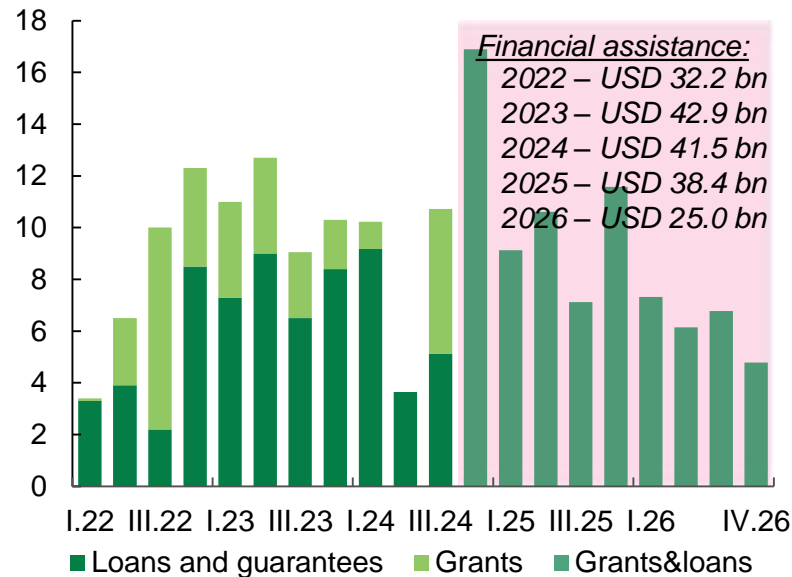
Financial account: net inflow, bn USD



Source: NBU staff estimates.

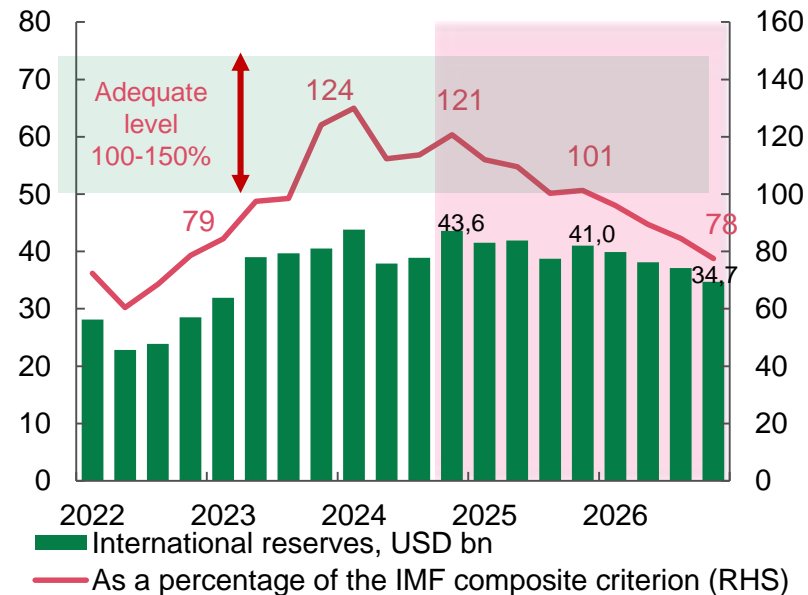
Despite the expected decline in international aid and moderate FX liberalization as conditions allow, reserves will remain relatively high

Financial assistance, bn USD



Source: NBU staff estimates.

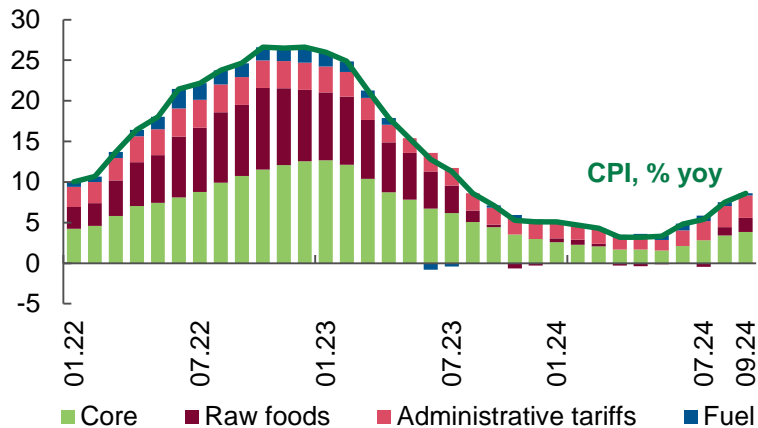
International reserves



Source: NBU staff estimates.

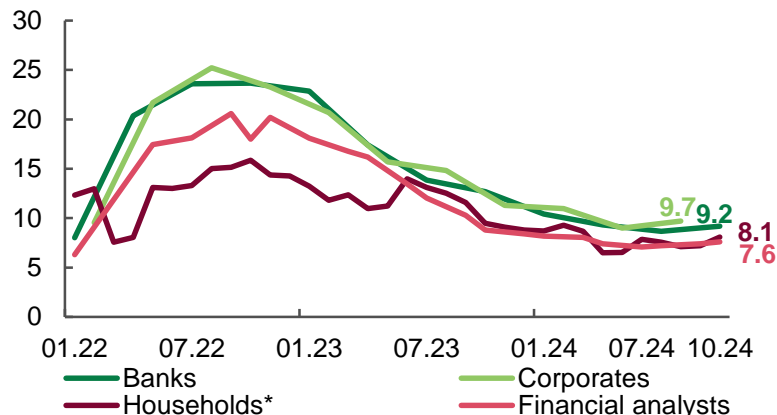
Fundamental inflation pressure is stronger than forecast due to cost effects. Expectations remain under control

Contributions to annual CPI growth by main components, pp



Source: SSSU, NBU staff estimates.

Inflation expectations for the next 12 month, %



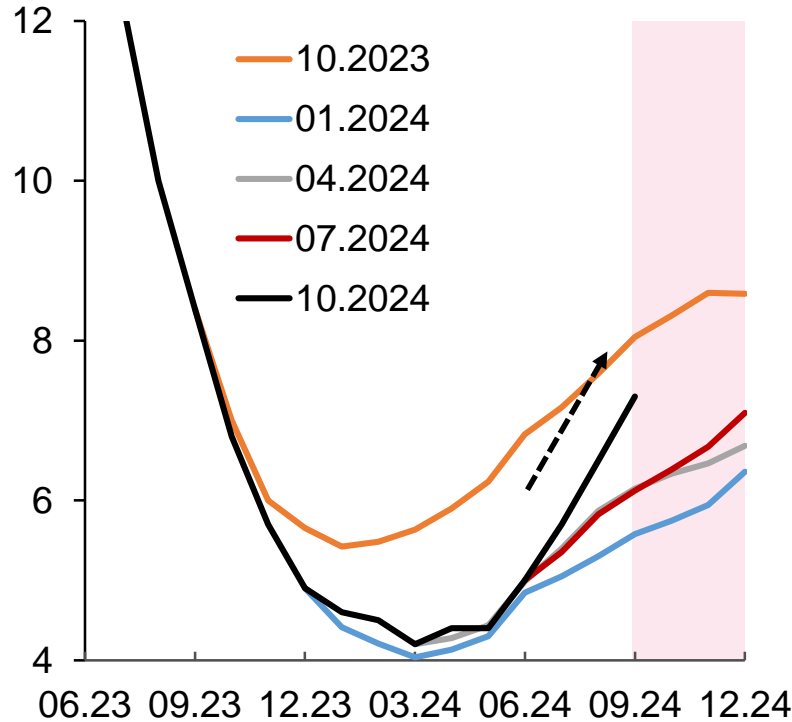
* In March 2022, the survey method was changed from face-to-face to telephone interviews.

Source: NBU, Info Sapiens.

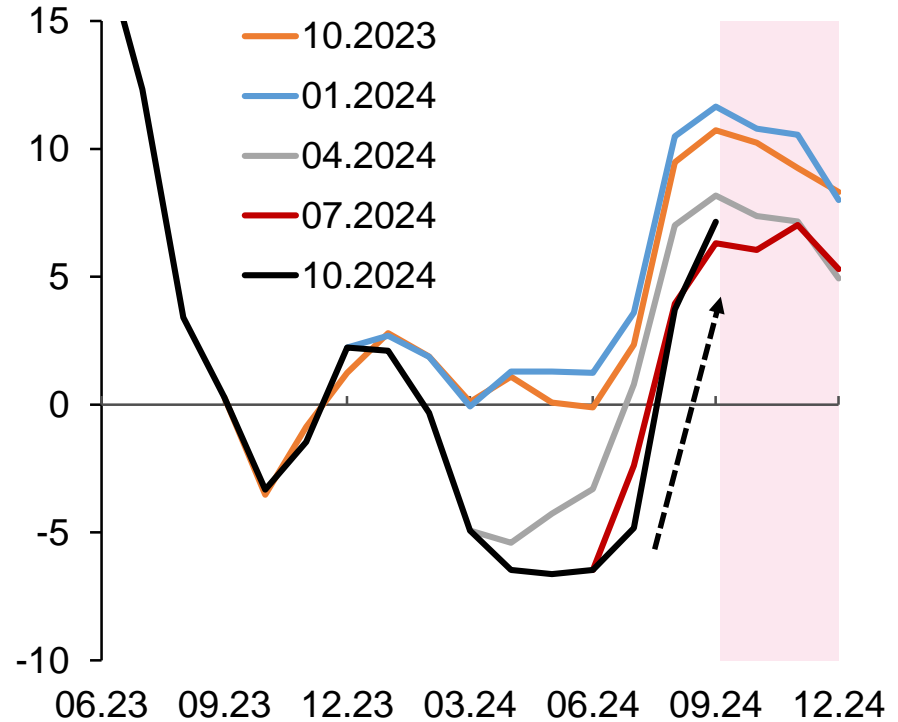
- **Consumer inflation accelerated to 8.6% yoy and was slightly above the NBU's July forecast.** The deviation was primarily caused by a shorter supply of raw food products because of draughts
- **Core inflation increased to 7.3% yoy and exceeded expectations,** driven by the pass-through of higher business costs for raw food inputs, energy, and labor shortages, and the effects from the depreciation of the hryvnia exchange rate in previous months
- **However, inflation expectations remained generally stable.** The moratorium on raising certain utility prices for households continued restraining the increased administered prices. Growth in fuel prices decelerated sharply

Reversal of core and food inflation in Q3 was expected (forecasted in January, April and July)

Core inflation forecasts, yoy, %

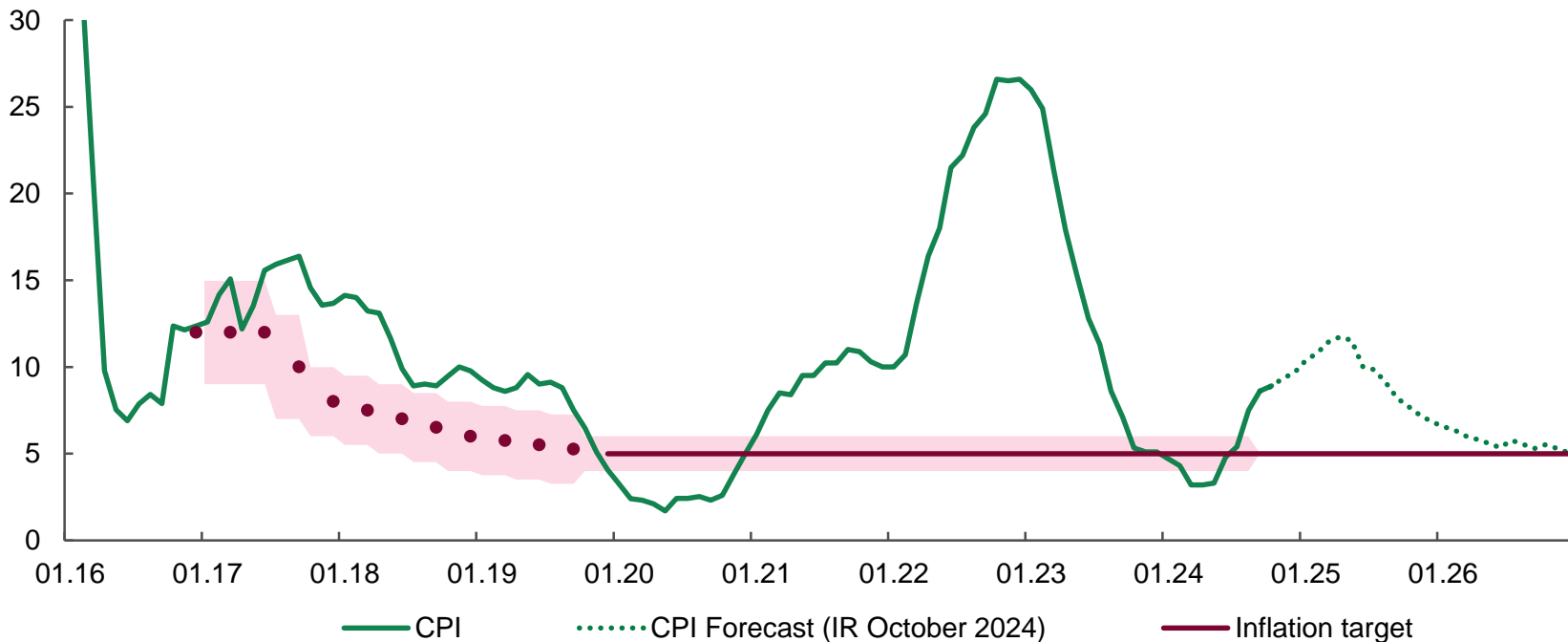


Raw foods forecasts, yoy, %



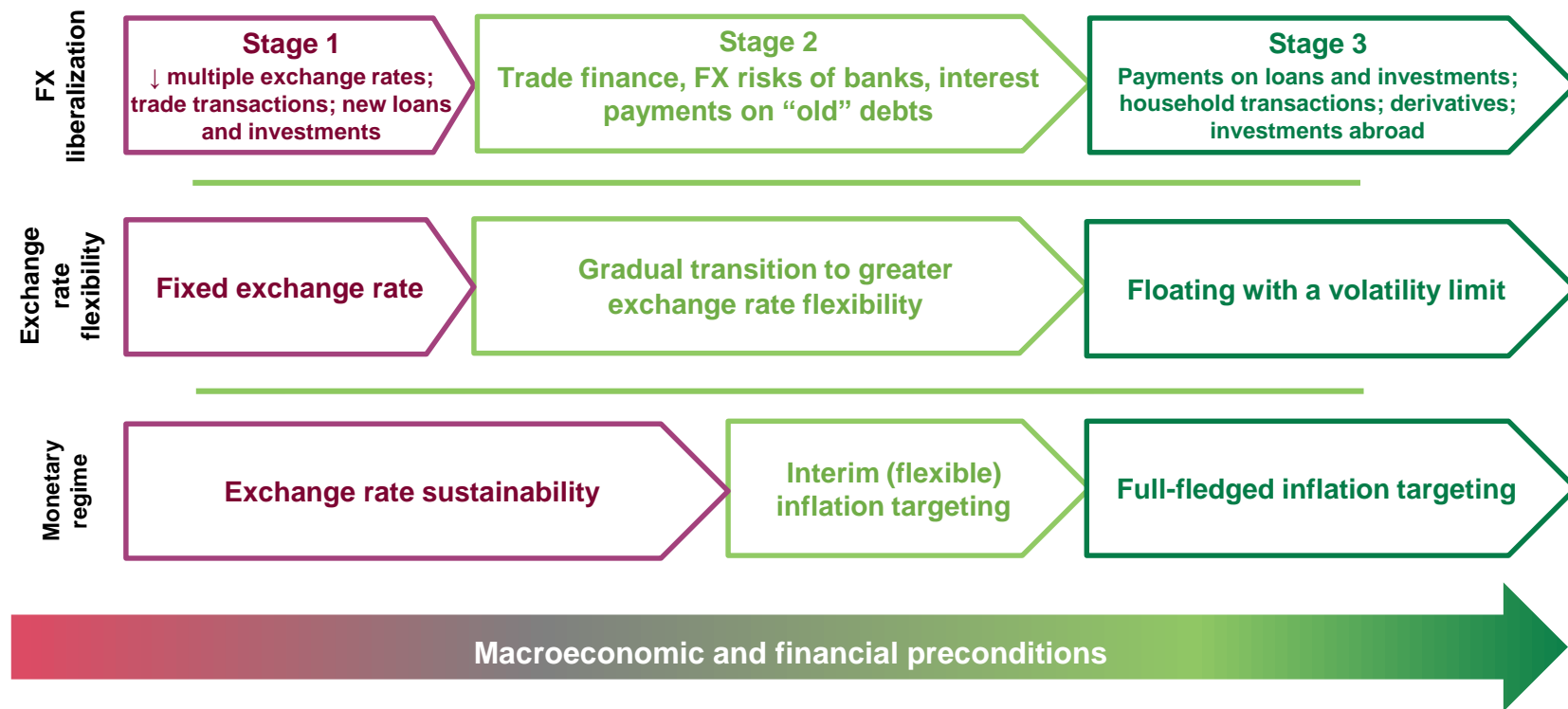
NBU will bring it to 5% target on the policy horizon

Inflation and inflation target, % yoy



Source: SSSU, NBU Inflation Report (October 2024).

The NBU has committed* to ease FX restrictions in an orderly, consistent way



The NBU introduced the regime of flexible inflation targeting to maintain price stability while normalizing FX market conditions

FLEXIBLE INFLATION TARGETING

Monetary policy is aimed at bringing inflation, measured by year-over-year CPI, to a target of 5% within the relevant policy horizon (up to 3 years)

Inflation may temporary deviate from the target when influenced by domestic and external factors beyond the effective control of the NBU's monetary policy

On the way back to a floating exchange rate, the NBU will continue to pursue a transitional regime that operates on the principles of **managed flexibility of the exchange rate**

! The NBU will continue to work towards the important monetary policy task of **ensuring a sustainable and manageable stance of the FX market**

Main features of the regime

- point inflation target + extended policy horizon
- managed flexibility of the exchange rate
- consistent combination of interest rate and exchange rate policy instruments, FX restrictions, and other tools to ensure price stability

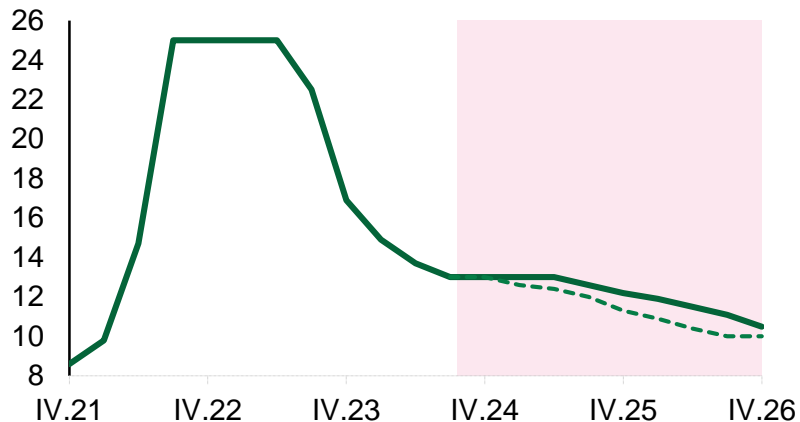
- facilitating the adaptation of the Ukrainian economy to shocks and maintaining its recovery
- while retaining control over inflation expectations

- supporting the role of the exchange rate as a shock absorber
- keeping FX and inflation expectations in check

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

In October, the NBU kept the key policy rate at 13%. The easing cycle is postponed on forecast due to higher inflation pressures

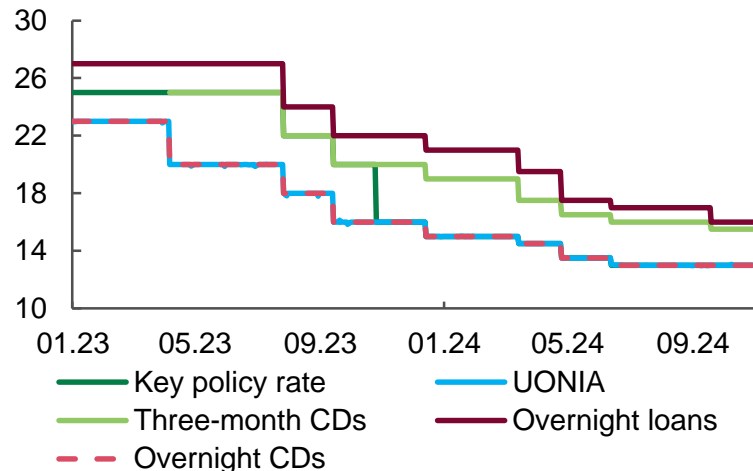
Key policy rate, %



* dashed line – previous forecast

Source: NBU forecast, October 2024

Interest rates on NBU open market operations and Ukrainian OverNight Index Average (UONIA), %

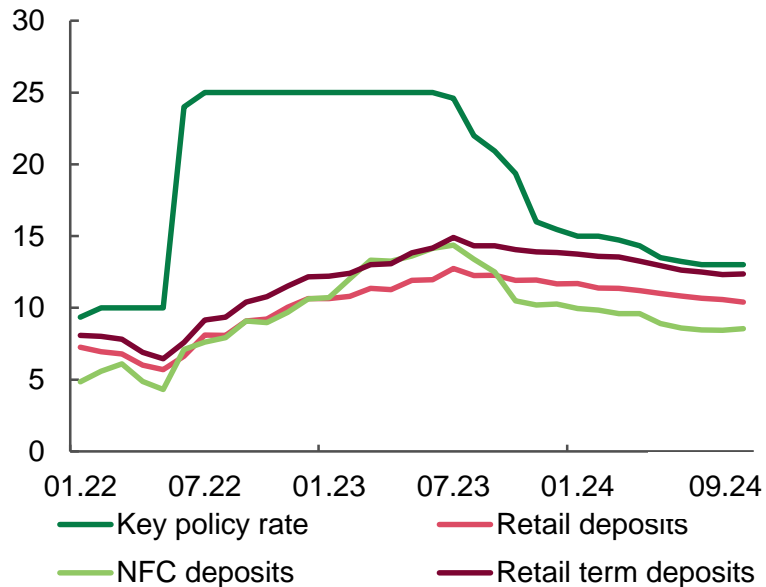


Source: NBU.

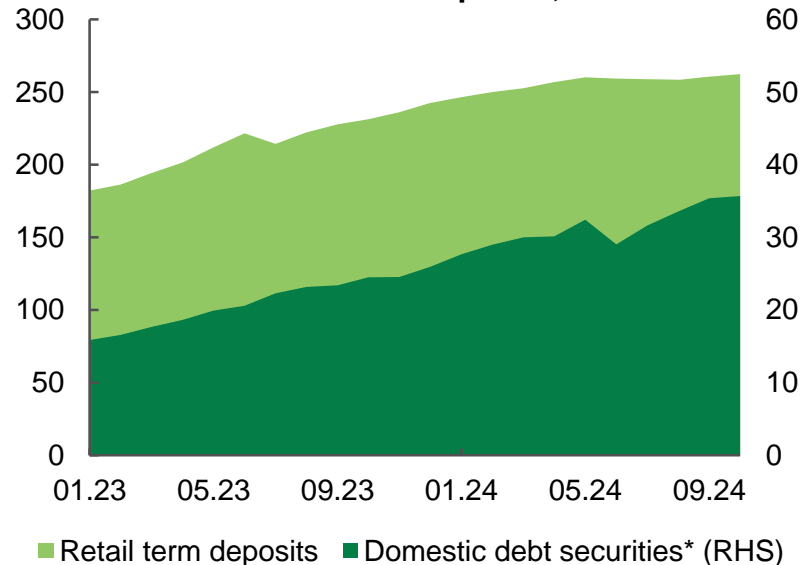
- The October decision to keep the key policy rate at 13% is aimed at sustaining interest in hryvnia assets and curbing demand in the FX market
- Additionally, in September the NBU applied a combination of measures to enhance banks' flexibility in managing their liquidity and to boost demand for government debt securities, thereby strengthening the government's ability to secure enough funding in the domestic debt market and avoid monetary financing

HH maintain interest in hryvnia instruments. The portfolio of hryvnia domestic debt securities held by HH resumed growth

Weighted average interest rates on hryvnia deposits and monthly average key policy rate, %



Stock of hryvnia domestic debt securities held by individuals and retail term deposits, UAH bn

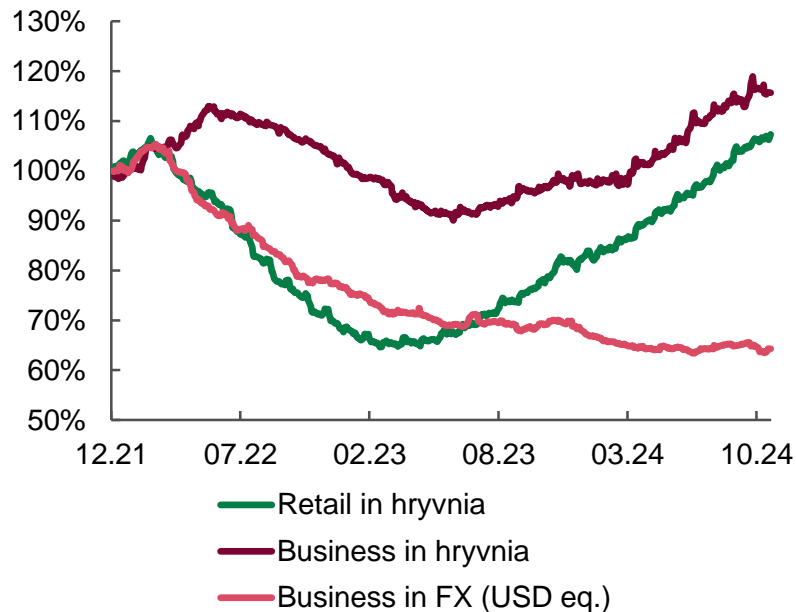


Source: Thomson Reuters.

* Preliminary data. ** At outstanding nominal value.
Source: NBU.

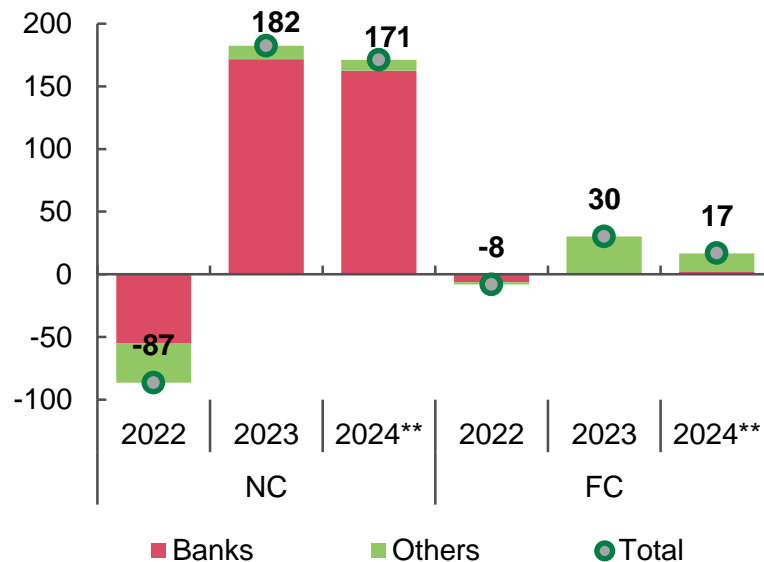
Banks step up hryvnia lending and investment in government debt

Net loans, 1 Jan 2022 = 100%



Source: NBU.

Portfolios of domestic government debt securities in national (NC)* and foreign currencies (FC) by holders, UAH bn



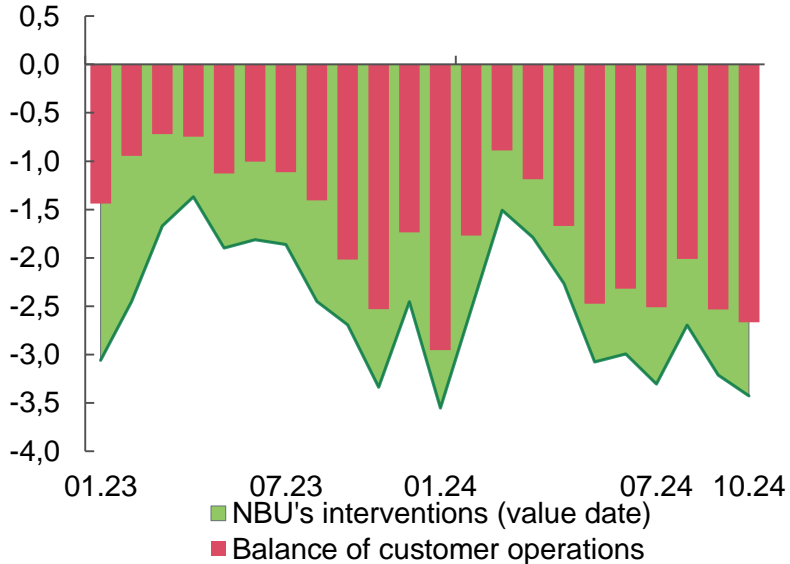
* Without transactions of NBU.

** January-October 2024.

Source: NBU.

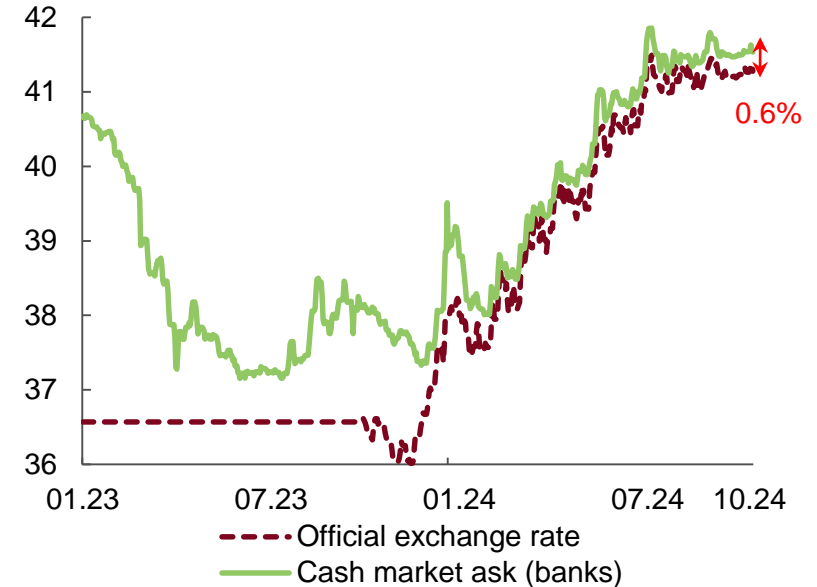
The exchange rate is gradually restoring its role as the shock absorber, moving in both directions according to market conditions

Bank clients' FX transactions* and NBU FX interventions, USD billions



* Net sale and purchase of noncash and cash foreign currency by bank clients (Tod, Tom, Spot).
Source: NBU.

Hryvnia exchange rates, UAH per USD



Source: NBU.

The balance of risks is shifted towards increased price pressure

Probability of Risk Occurrence

Low	Average	High
<15%	15%–25%	25%–50%

Degree of impact on the baseline scenario

Weak

Restoration of the blockade of the western borders or establishing additional restrictions on access to the European market

Moderate

Rapid restoration of damaged energy infrastructure

Increased emigration
Growing geopolitical tensions

Potential pass-through of additional tax increases and/or introduction of new taxes to prices

Strong

Rapid implementation of the large-scale plan for the reconstruction of Ukraine

Changes in the announced volumes of international aid

Escalation of hostilities, further destruction of production facilities
Higher electricity deficit due to further damage to the energy infrastructure
Additional budgetary needs

Conclusions

- Despite the full-scale invasion and continuous terrorist attacks of russia, the Ukrainian financial system and the NBU are well functioning and supporting war efforts
- NBU's policy priorities remain the same: ensuring price and financial stability. At the same time, the NBU is employing policy initiatives to support the sufficient financing of budget needs in debt market and bolster adaptivity of the economy to new potential shocks
- The NBU's flexibility was formally stipulated by the updated Monetary policy Guidelines, which officially introduced the flexible inflation targeting regime
- NBU's measures helped stabilize the FX market, keep inflation moderate, restore credibility to hryvnia and maintain international reserves at sufficient level. Despite the risks and intensified price pressures, the NBU will bring inflation to its target level of 5% on the policy horizon
- NBU is actively cooperating with the banking system to implement the Lending Development Strategy, which will contribute to economic growth and establish the basis for the reconstruction
- While the balance of risks is tilted to the downside, resilience of the financial system as well as adaptability of businesses amid lower expected electricity shortages will support economic recovery



National Bank of Ukraine

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