



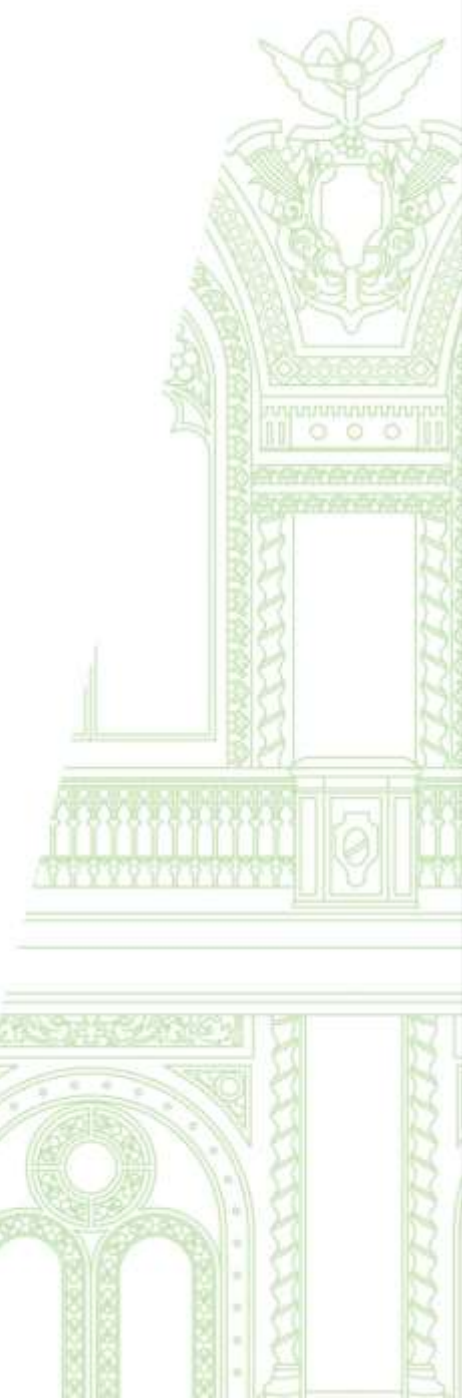
National Bank
of Ukraine

National Bank of Ukraine and Monetary Policy Framework

Volodymyr Lepushynskyi

Director of Monetary Policy and Economic
Analysis Department

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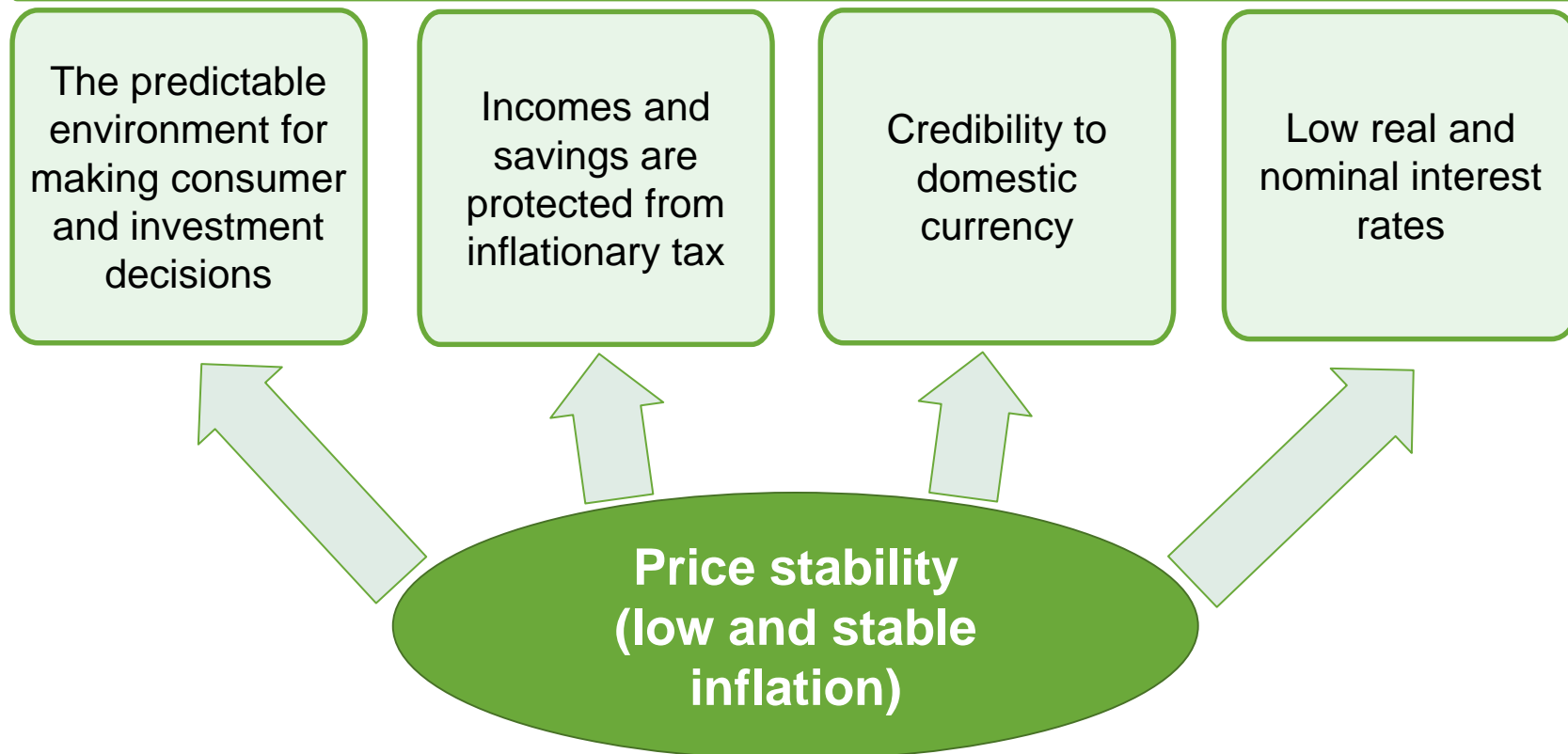




1. Modern approaches to monetary policy

Price stability is a key objective of the monetary policy

Favorable conditions for economic growth and employment



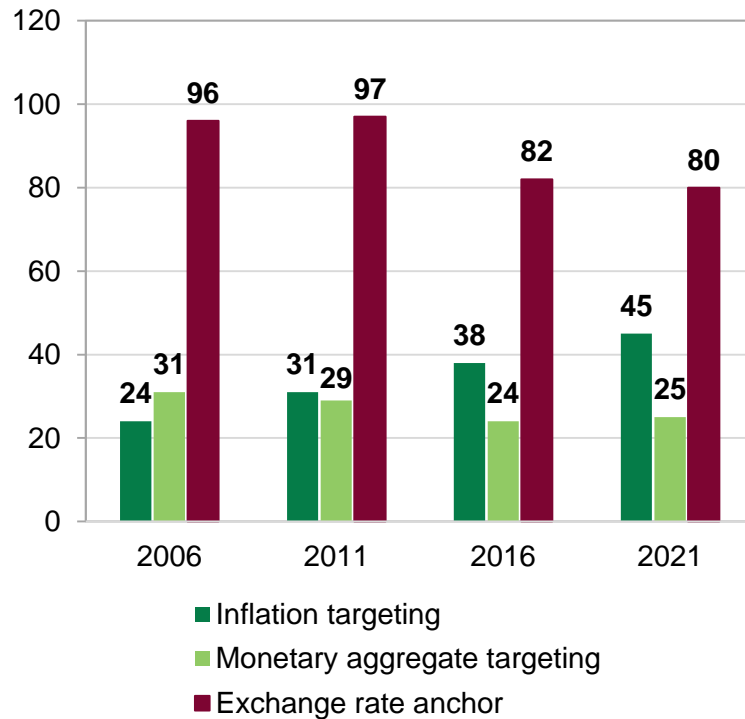
- *Inflation is always and everywhere a monetary phenomenon* (M. Friedman)
- The unique CB's function – to supply money for the economy – naturally determines responsibility of CB for the price stability

Monetary frameworks

Regime	Nature	Advantages	Disadvantages
Fixed exchange rate	Maintaining the exchange rate stability	Allows to reduce inflation fast Clear targets, well perceived by the population	Monetary policy loses its independence Economy suffers from shocks and financial instability
Monetary targeting	Determining the target level of money growth	High level of coordination between monetary policy and macroeconomic policy Fast response in the case of target change	Precondition is a stable demand for money For general public it is not easy to understand
Inflation targeting	CB's responsibility for achievement of inflation target	Long-term objective with short-term flexibility Systemic approach and predictability	Effects of non-monetary factors on inflation Anchoring inflation expectations takes up time
Nominal GDP level (or growth) or price level targeting	Commitments to maintain a certain level (or growth rate) of nominal demand or a certain level of prices	Mixed objectives of CB (balancing between inflation and output gap) Commitment to speed up inflation in a future	Delays in GDP data publication, frequent updates Absence of prioritization of objectives, difficulties with communications and accountability

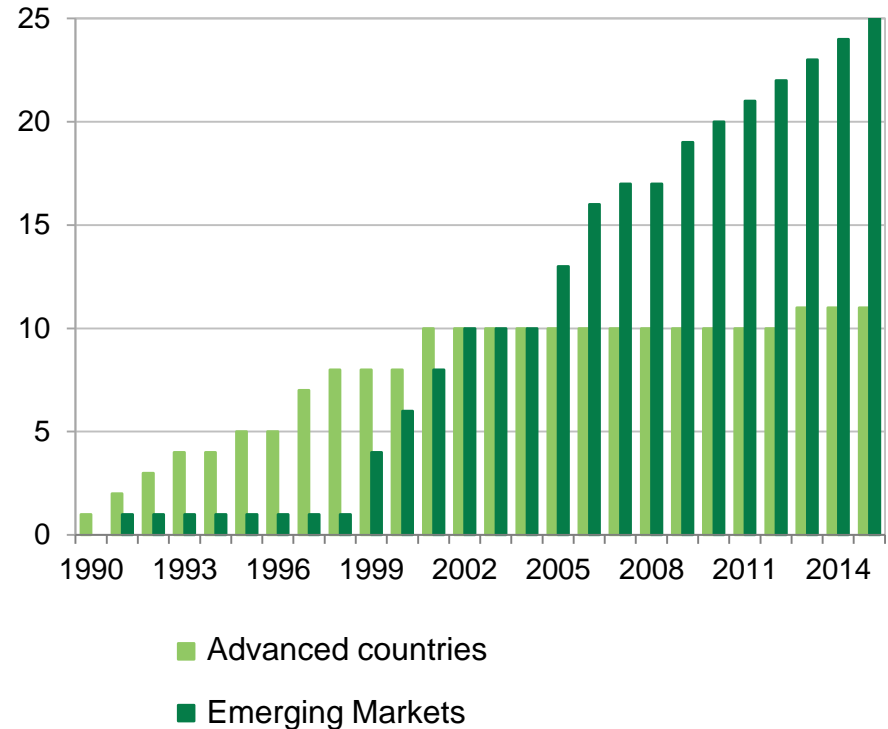
The popularity of the inflation targeting regime is growing ...

Monetary policy framework



Source: IMF, Annual Reports on Exchange Arrangements and Exchange Restrictions, 2006, 2011, 2016, 2021

Countries with the IT regime, 1989-2015



Source: Klaus Schmidt-Hebbel, Martín Carrasco (2016)

What is Inflation Targeting regime?

 **Inflation as the only quantitative target**

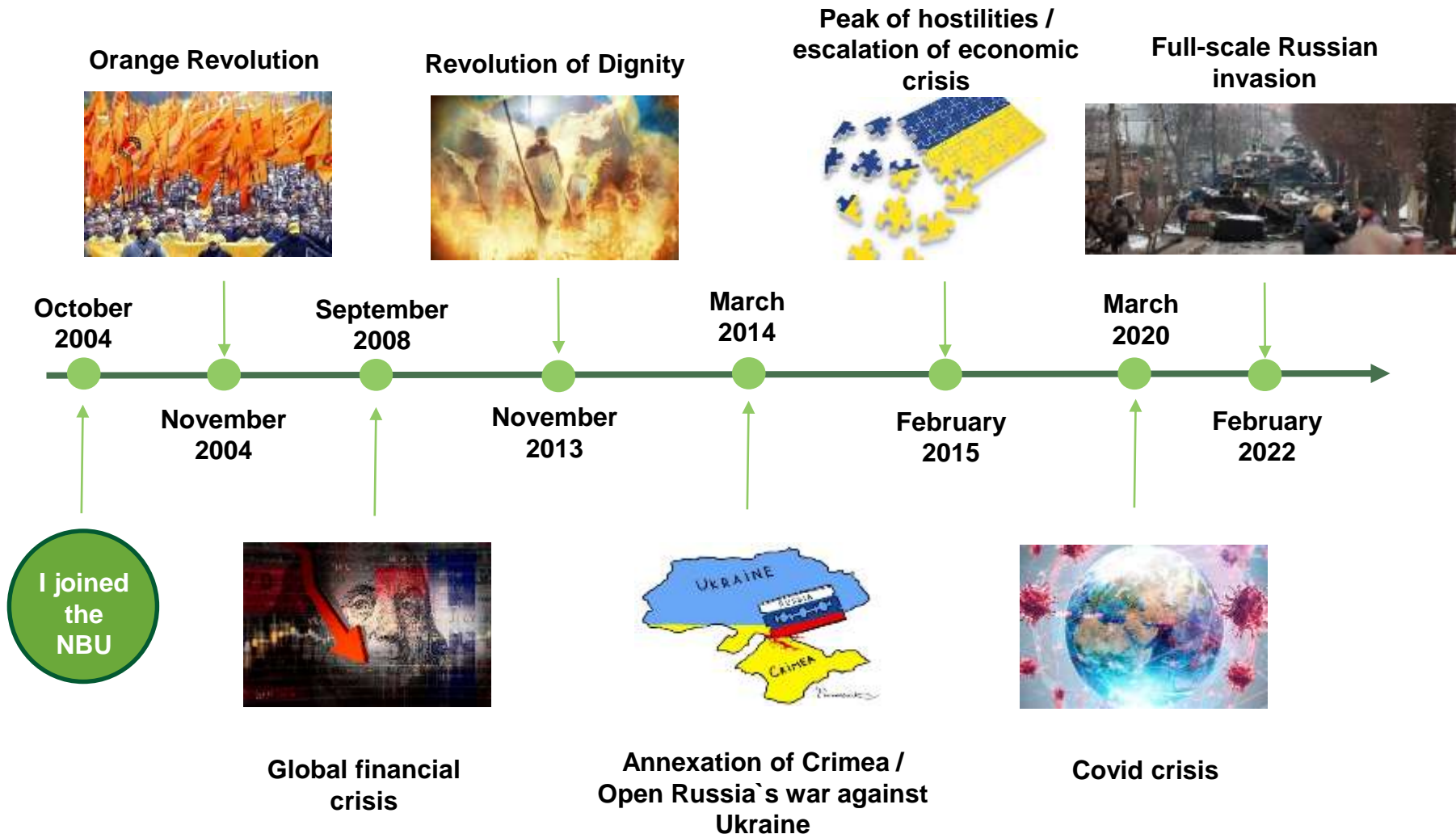
Clear institutional mandate for the central bank to achieve it

- ❑ A collection of modern central banking practices
- ❑ Changes the way monetary policy is done
 - Relatively flexible exchange rate
 - Policy based on interest rate changes
 - Strong emphasis on forecasts and analysis of risks
 - Focus on transparency and accountability
- ❑ Appealing long-term solution for many countries
 - Some adopted it out of necessity in a balance-of-payments crisis

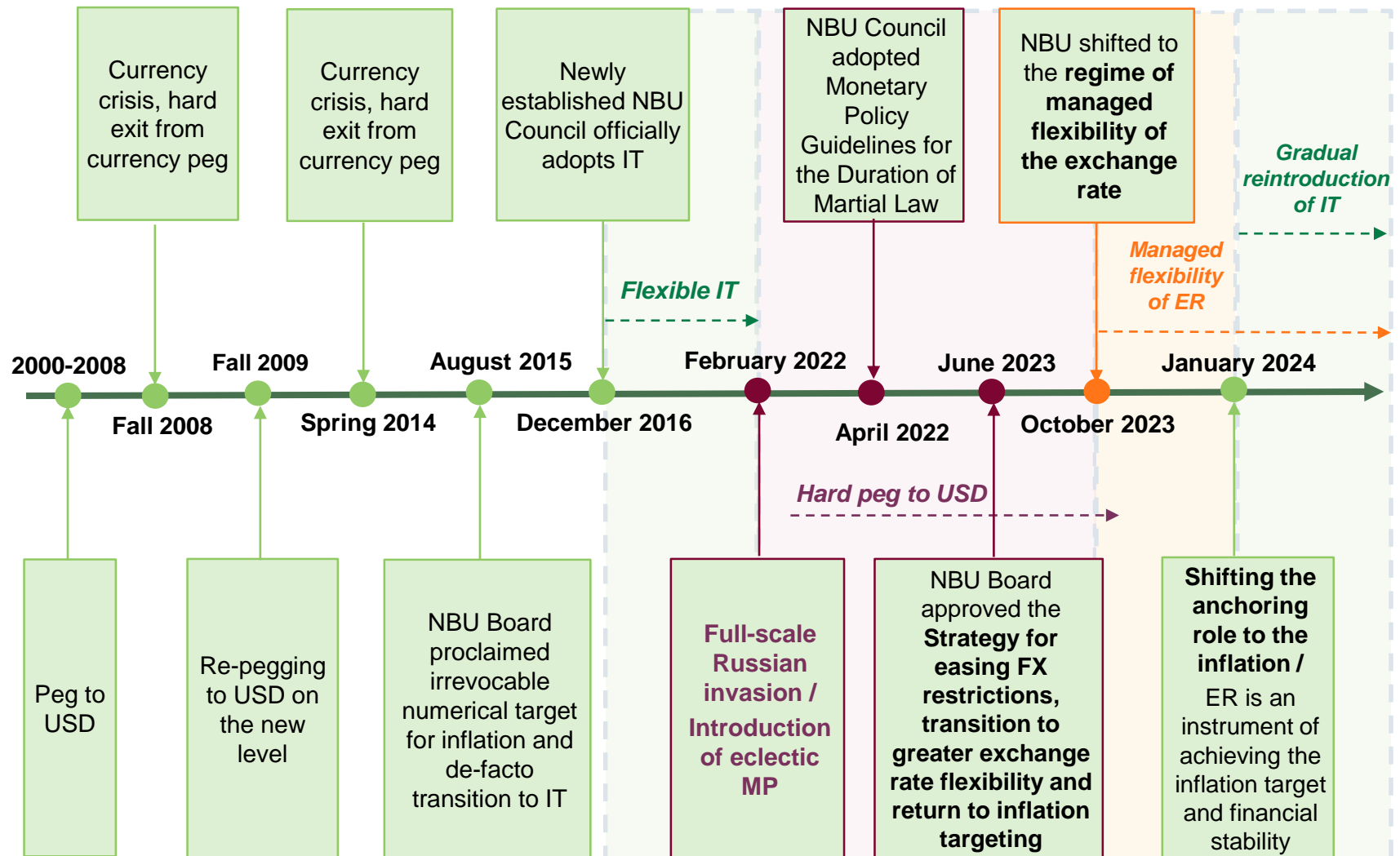


2. Evolution of monetary regime in Ukraine

The general context of economic policy is hardly predictable. Hence, Ukraine needs the highly credible monetary policy



Evolution of monetary regimes in Ukraine

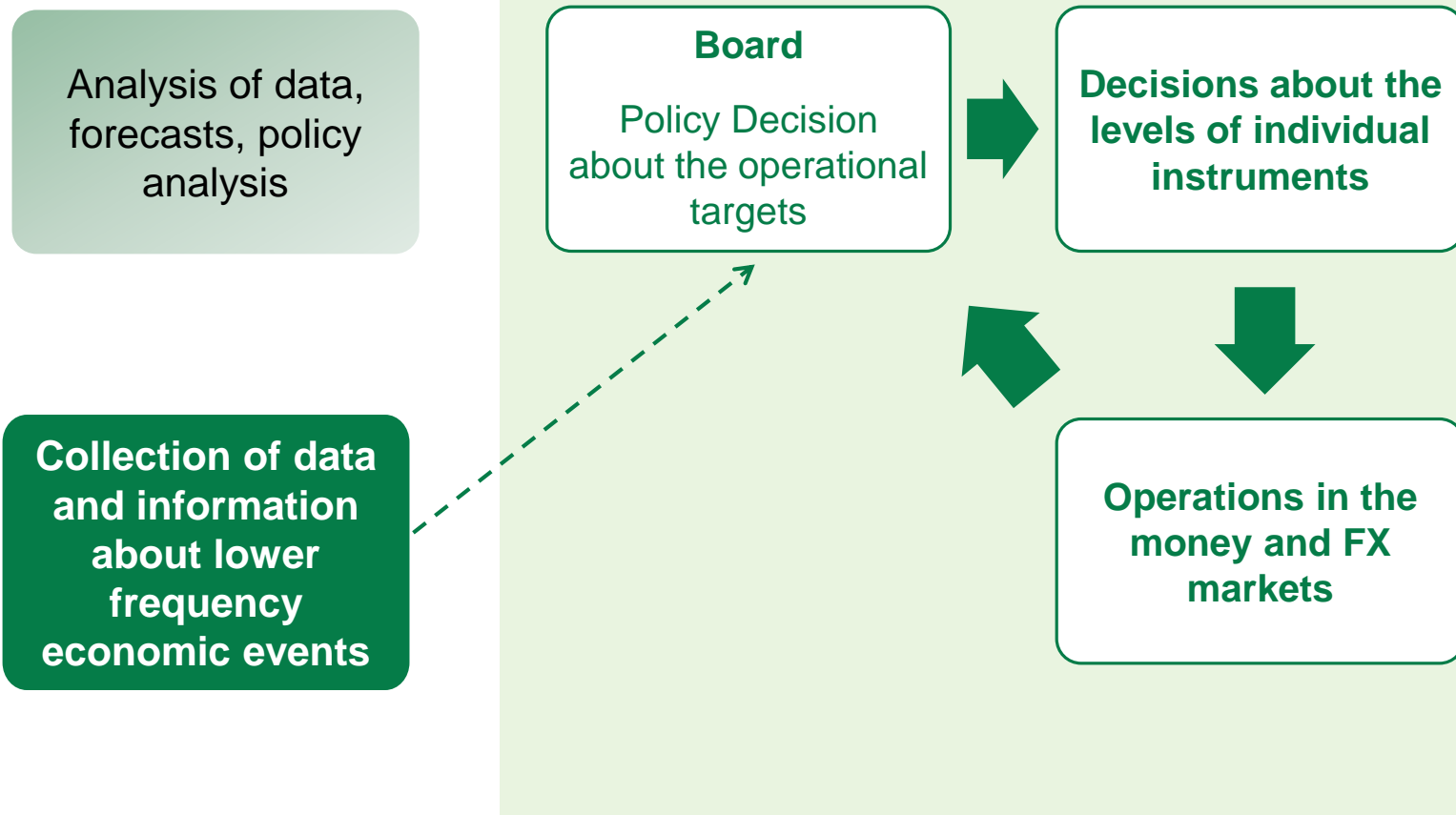


To be credible there is the need to have clear monetary strategy

	<i>Before IT (-2013)</i>	<i>After IT adoption (2016-)</i>
Objectives	Numerous and changeable objectives (ER, monetary aggregates, FX restrictions etc.)	Irrevocable inflation target
Decision making	De facto individual, non-transparent, lacking analytical support	Collegial, forward-looking, transparent
Instruments	Numerous instruments (interest rate, exchange rate, OMO, reserves requirements, refinancing loans)	One main instrument – key policy rate
Exchange rate regime	Peg to USD	Floating exchange rate
Transparency & predictability	Non-transparent central bank, incomprehensibility of goals, decision-making process, expected results	Transparency, communication with different target groups on the plans, goals and reasons behind the decisions

The pre IT period: chaotic decision-making, disrupted information flows, nothing to communicate

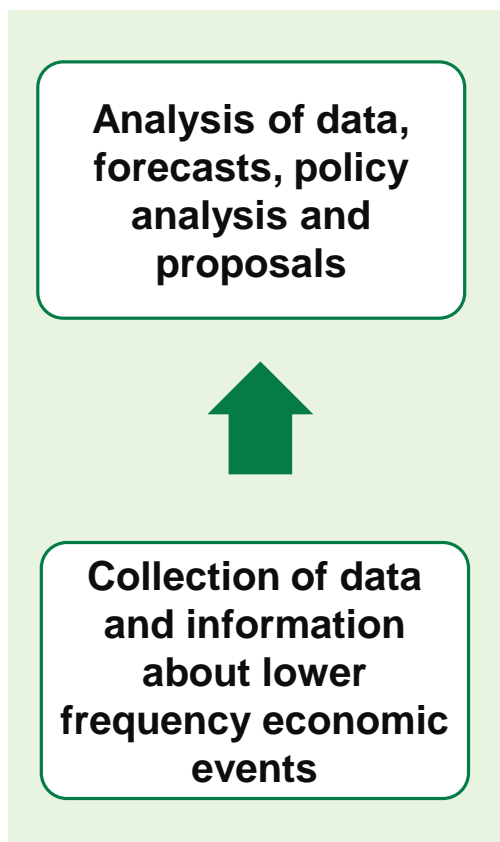
MP Formulation and Implementation



After IT introduction and nowadays: clear monetary policy decision-making as key prerequisite for communication

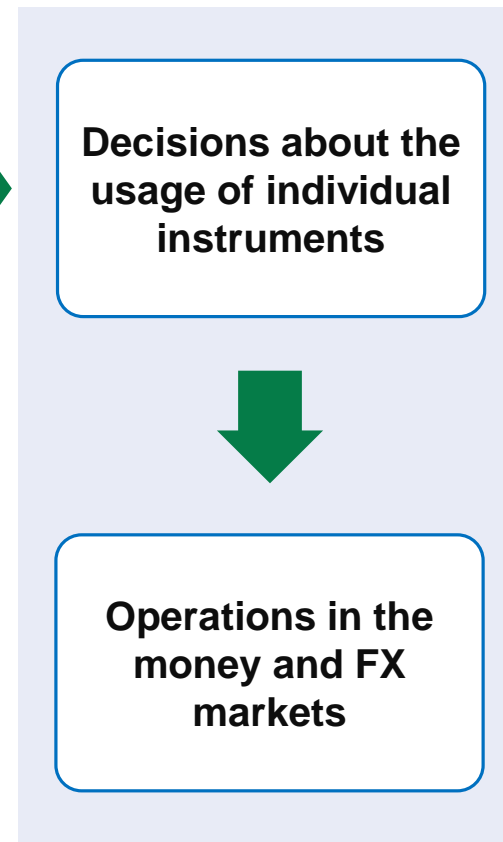
MP Formulation

(focusing at the macroeconomic effects of monetary policy decisions)



MP Implementation

(focusing at the achievement of operation targets)



Implementation of best practice in communications is bringing central bank to another reality (case of the NBU)



**NO
TALKING!**

NBU in 2013

Increase in transparency goes in line with complex reform of the NBU

NBU in 2019



Strategy of monetary policy:
clear numerical targets



Established decision-making & operational design of MP



Regular & proactive monetary policy communications
(press release, press briefing, Inflation Report, Minutes,
key policy rate forecast)



Broad public access to data



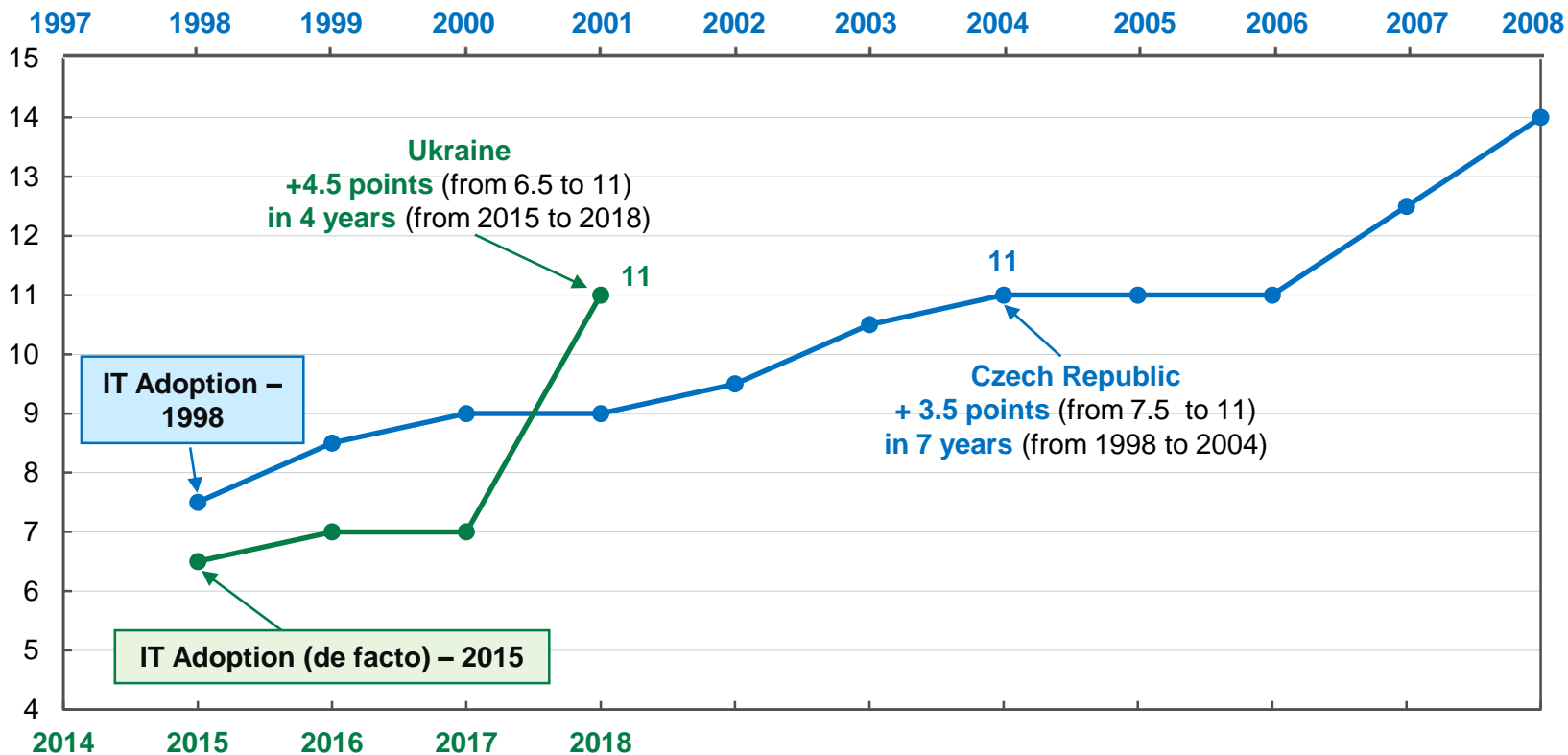
Expanding of communications in non-MP areas (financial
stability, banking supervision, payment systems, etc.)



Standard transparency practices of leading central banks

Communications are additional policy tool as well. The NBU used existing experience in order to achieve fast results

Monetary Policy Transparency Index



Source: [Dincer/Eichengreen/Geraats Central Bank Transparency Data for 1998-2019](#).

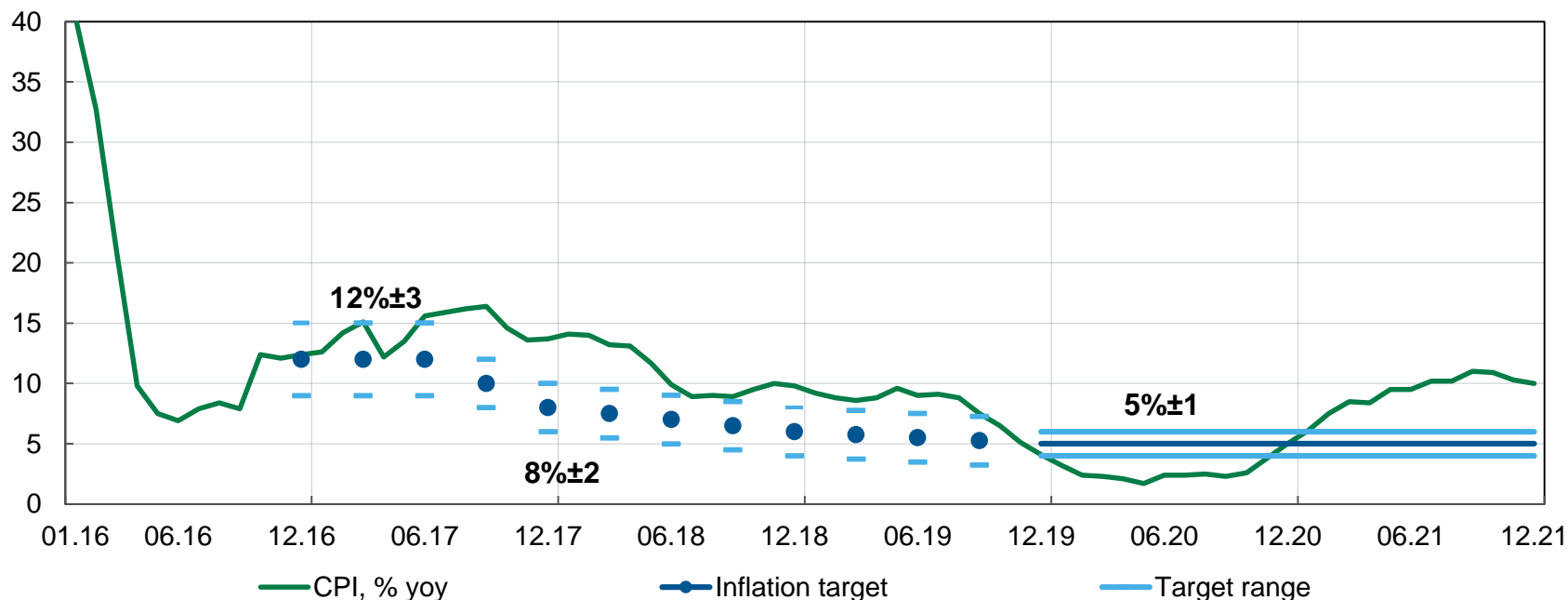
The NBU, following the examples of leading central banks on targeting inflation, has an opportunity to minimize the time lag between IT adoption and achieving a high level of monetary policy transparency



3. The NBU's monetary policy before full-scale invasion

Cornerstone of new monetary policy: adherence to announced inflation targets

CPI and Inflation Targets

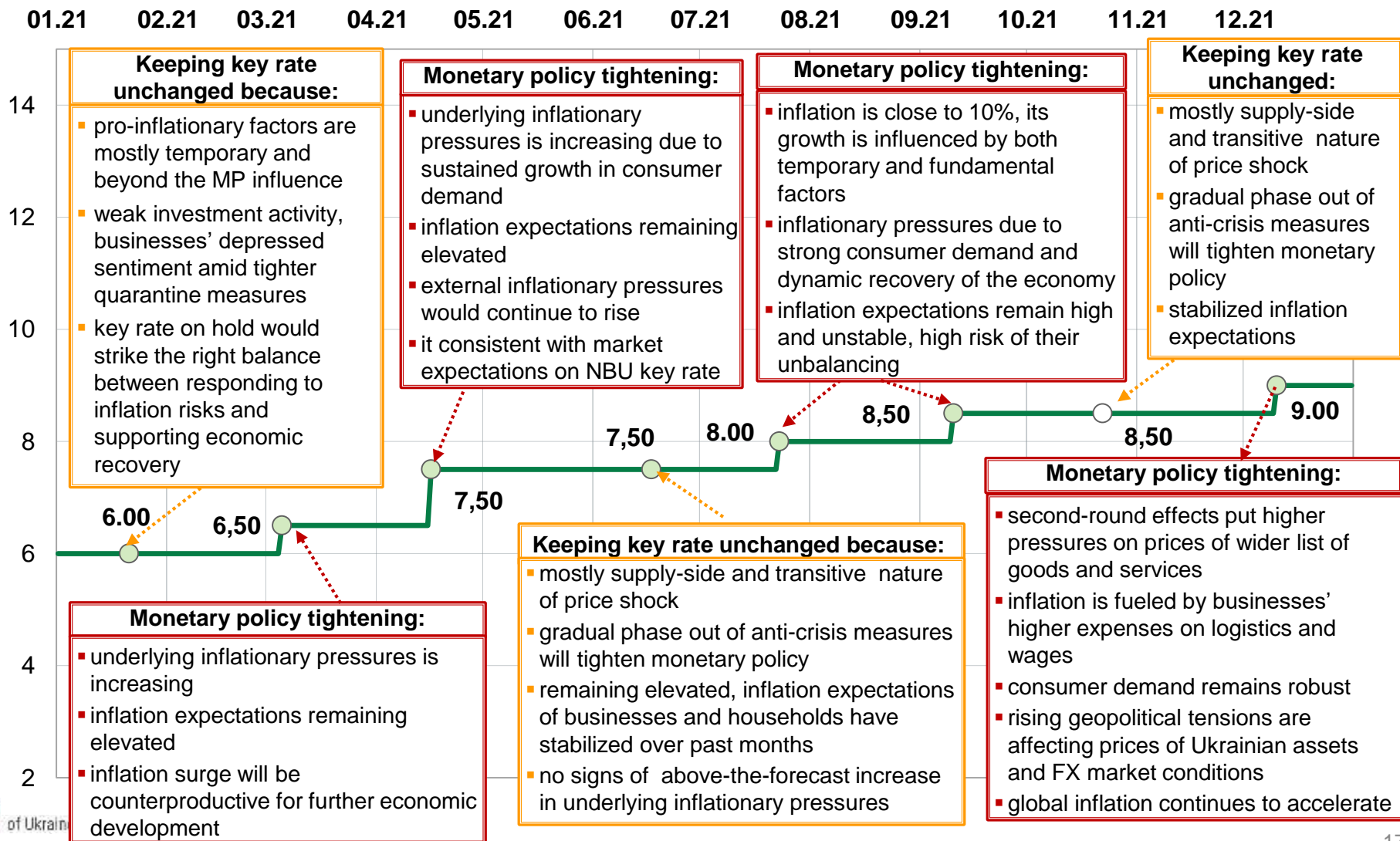


Source: SSSU, NBU staff estimates.

- The NBU started the transition to Inflation Targeting regime in 2015 in the midst of severe economic crisis
- In July 2018, the NBU Council adopted the Monetary Policy Strategy that confirms that the NBU will carry out its monetary policy based on the inflation targeting and its medium term inflation target of 5%
- The mid-term **inflation target could be revised only downwards**

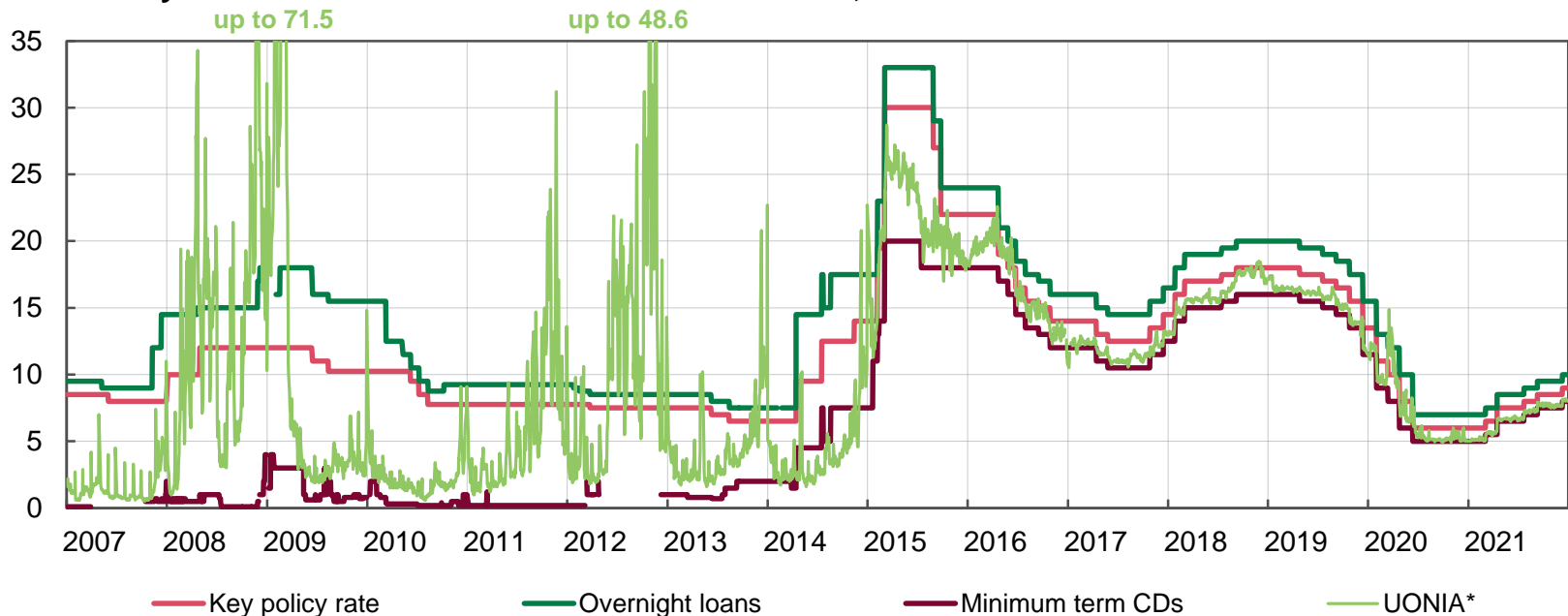
The NBU monetary policy decisions aimed at bringing inflation to 5% target and keeping inflation expectations under control

Key rate, %



Monetary transmission has strengthened thanks to the NBU's efforts to enhance the role of the key policy rate

NBU Policy Rates and Ukrainian Index of Interbank Rates, %



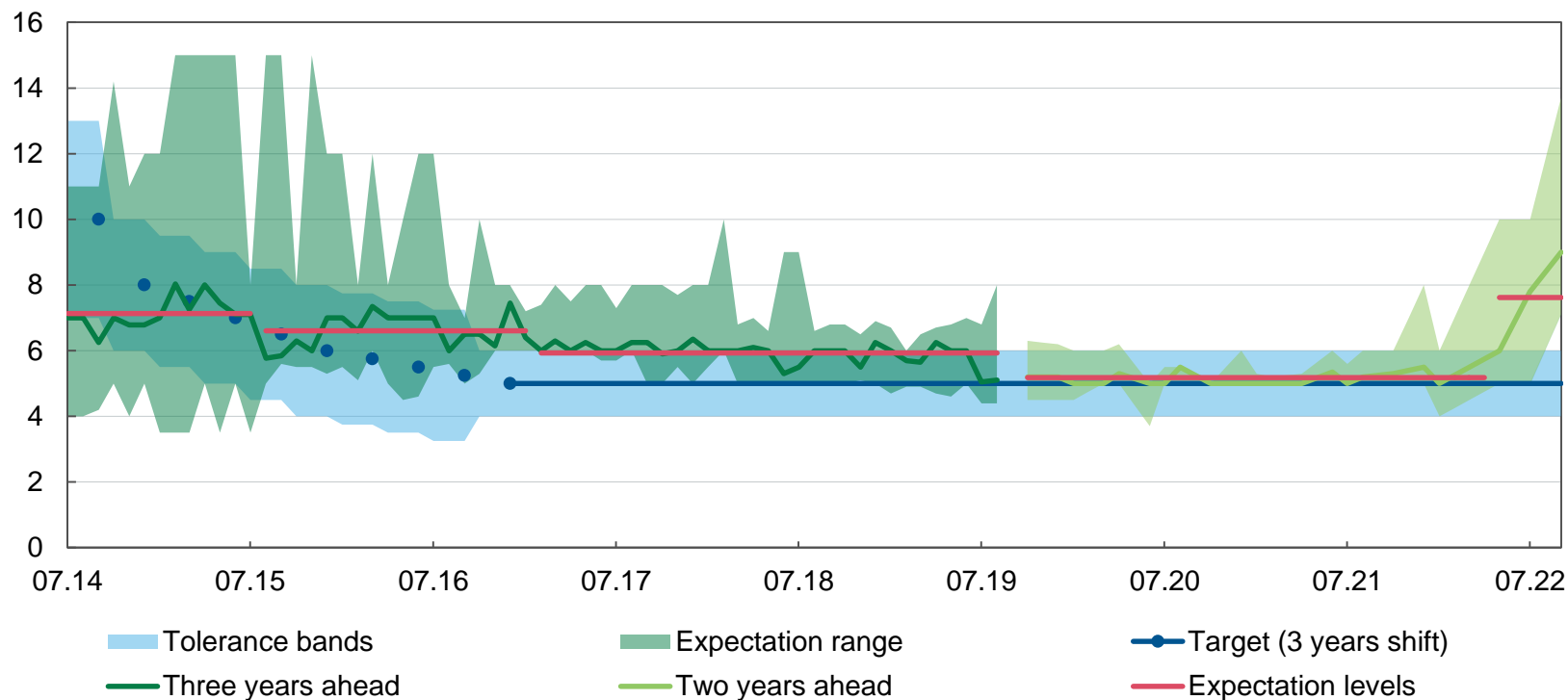
* Before 25.12.2015 – average interbank interest rate, 25.12.2015 - 22.06.2020 – overnight interbank (UIIR).

Source: NBU.

- Prior to 2015, the interest rate channel of monetary transmission mechanism was quite weak as key policy rate played a rather symbolic role in the money market
- Since 2015, IR pass-through improved significantly, particularly after the NBU switched to a new operational design of its interest rate policy
- The agenda for strengthening pass-through is still large, including broadening and deepening of the local financial market, developing capital market, reducing dollarization, etc.

Credible inflation targeting showed fast results. Level in inflation expectations gradually approached the target

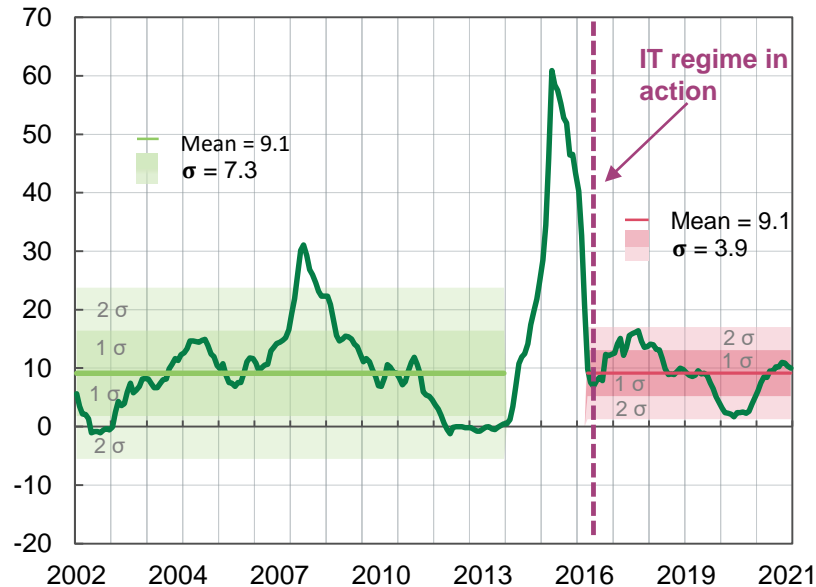
Medium-term IE of financial analysts and their range*, %



* Median value. The estimation of IE levels was done using the [Bai and Perron \(2003\)](#) methodology.
Source: NBU.

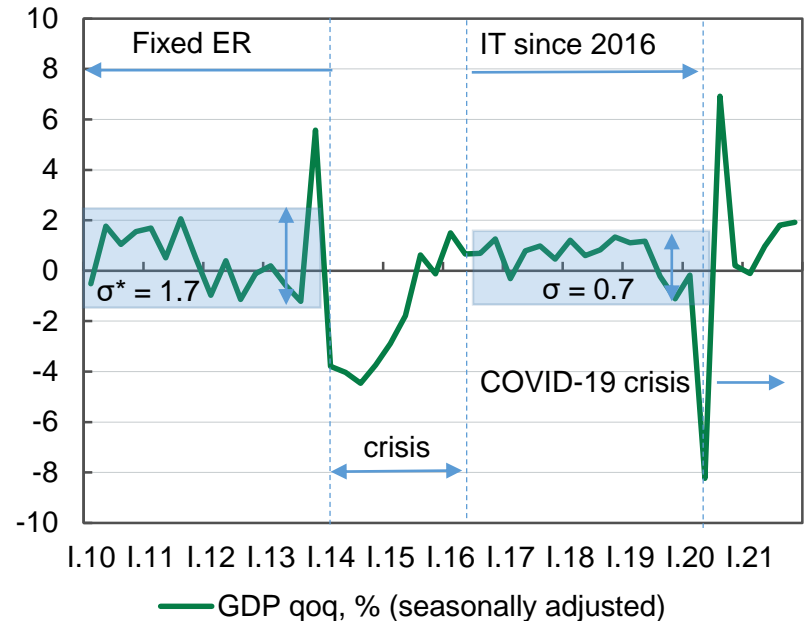
The results of credible monetary policy

Consumer inflation and its volatility, % yoy



Source: SSSU, NBU staff estimates.

GDP volatility

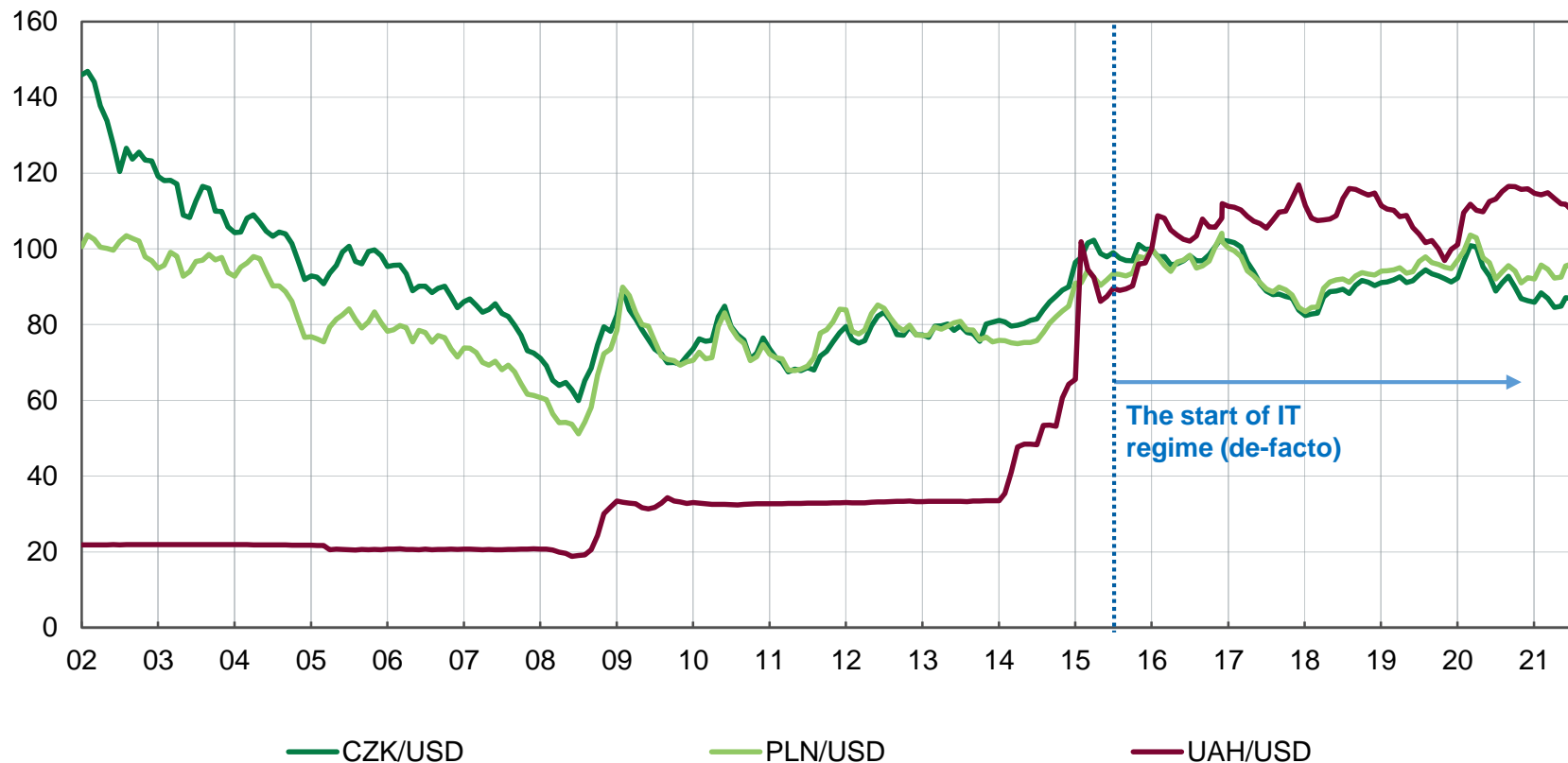


* σ – standard deviation.

Source: SSSU, NBU staff estimates.

Inflation targeting in the long run provides a more stable exchange rate than a peg...

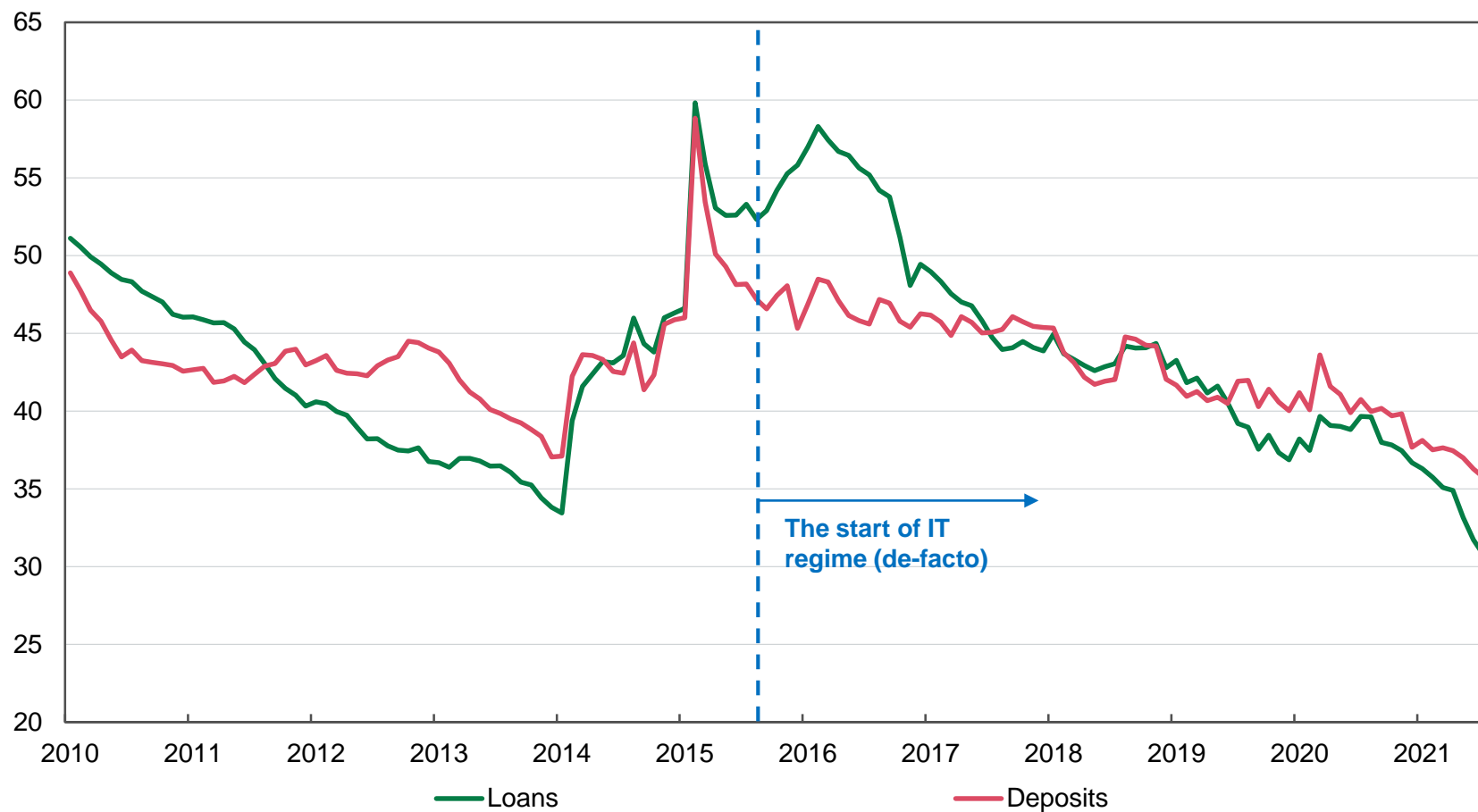
Exchange rates of hryvnia, Czech koruna and Polish zloty to US dollar, Jan-2016=100



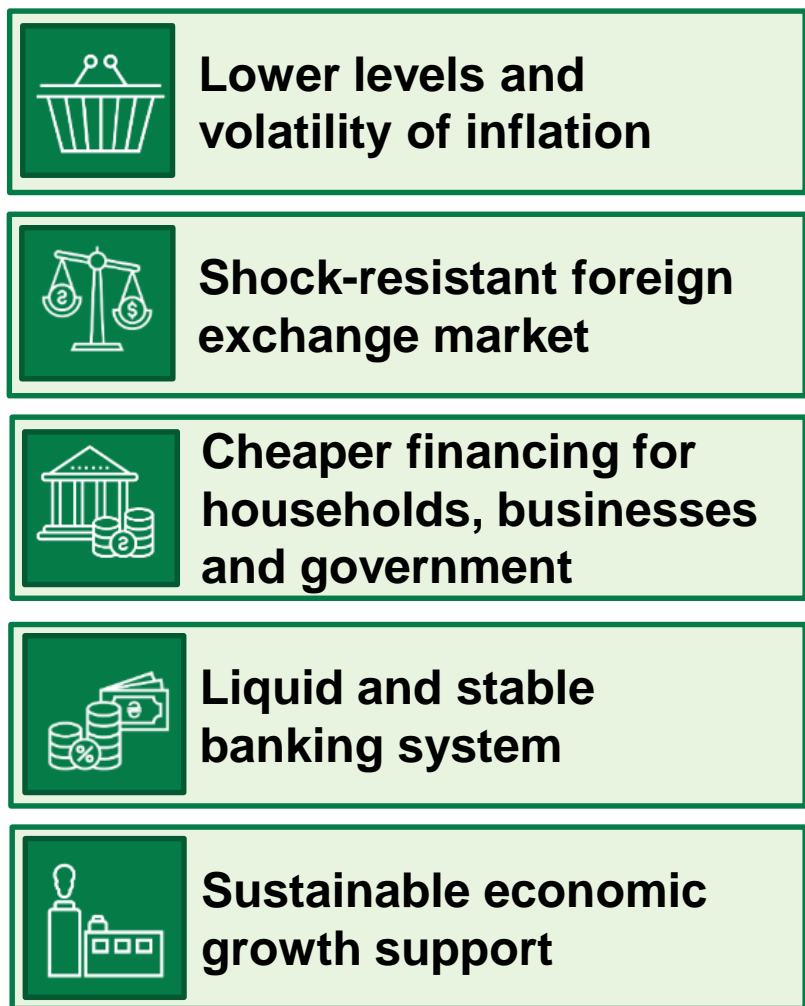
Source: IMF, NBU estimates.

...and maintains a steady trend towards de-dollarization of the economy

Share of loans and deposits in foreign currency, %



TOP-5 NBU's achievements due to IT and floating exchange rate



AS A RESULT

1

The Ukrainian economy **faced russia's full-scale invasion with a greater margin of safety**, compared to previous crisis episodes



Together with the measures of the NBU and the government, this allowed to prevent a panic and FX crises, ensure smooth functioning of the banking and payment systems, uninterrupted financing of Ukraine's defense needs and other critical budget expenditures, to ensure persistent disinflation and return to economic growth

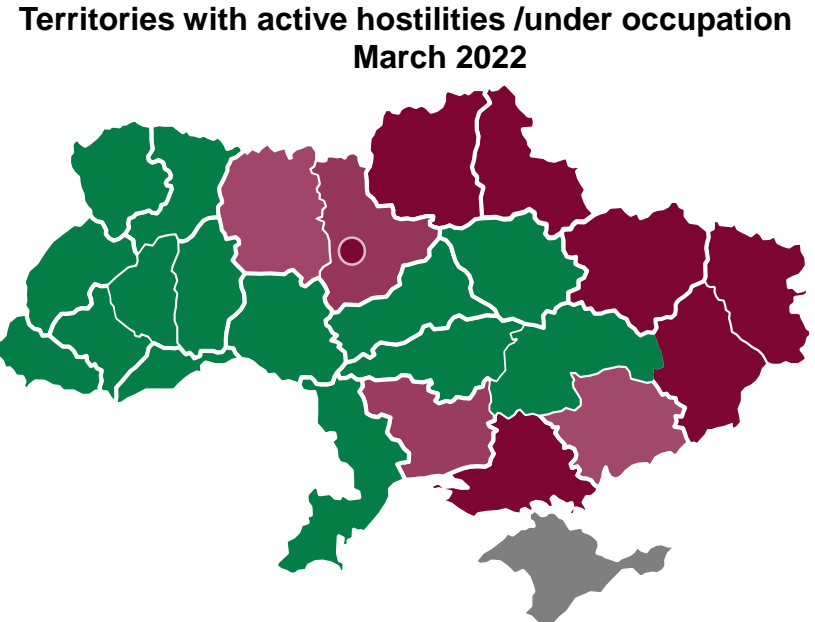
2

Thanks to the operative actions of the NBU, **the economy overcame the first difficult months of the war and was able to adapt to new conditions**



4. Monetary policy during full-scale invasion

The full-scale russian invasion started on 24 February 2022



Source: NBU.

- The bombardments started in the early morning at 4:00, February 24
- Occupants invaded eight regions of Ukraine and in several hours were at the outskirts of Kyiv, the capital

The factual invasion was a shock, but we had prepared the action plan in advance

The bombardment of Ukraine started at 4:00

At the beginning of business day, **9:00**, the NBU published **the list of measures it introduced to sustain financial stability**

How Ukraine's Banking System and FX Market Will Work from 24 February 2022 Under Martial Law Throughout Ukraine



24 Feb 2022 9:52

The National Bank of Ukraine has passed a Resolution outlining how Ukrainian banks will operate now that martial law has been imposed throughout the country. Martial law is a special regime under which:

- Banks ensure the uninterrupted operation of their branches unless doing so puts at risk the lives and health of the public.
- Banks continue to operate subject to the restrictions stipulated by this Resolution.
- Banks provide uninterrupted access to safe deposit boxes.
- It is ensured that all cashless payments go through without limitation.
- ATM cash replenishment is carried out without restrictions.
- The NBU provides unlimited cash support.
- The NBU grants unlimited unsecured refinancing loans to banks, with up to one-year maturity and an option to extend the loan by another year, so that banks can maintain their liquidity.
- Payments to and by the Ukrainian government are made without restrictions, in accordance with legislation governing this special period.

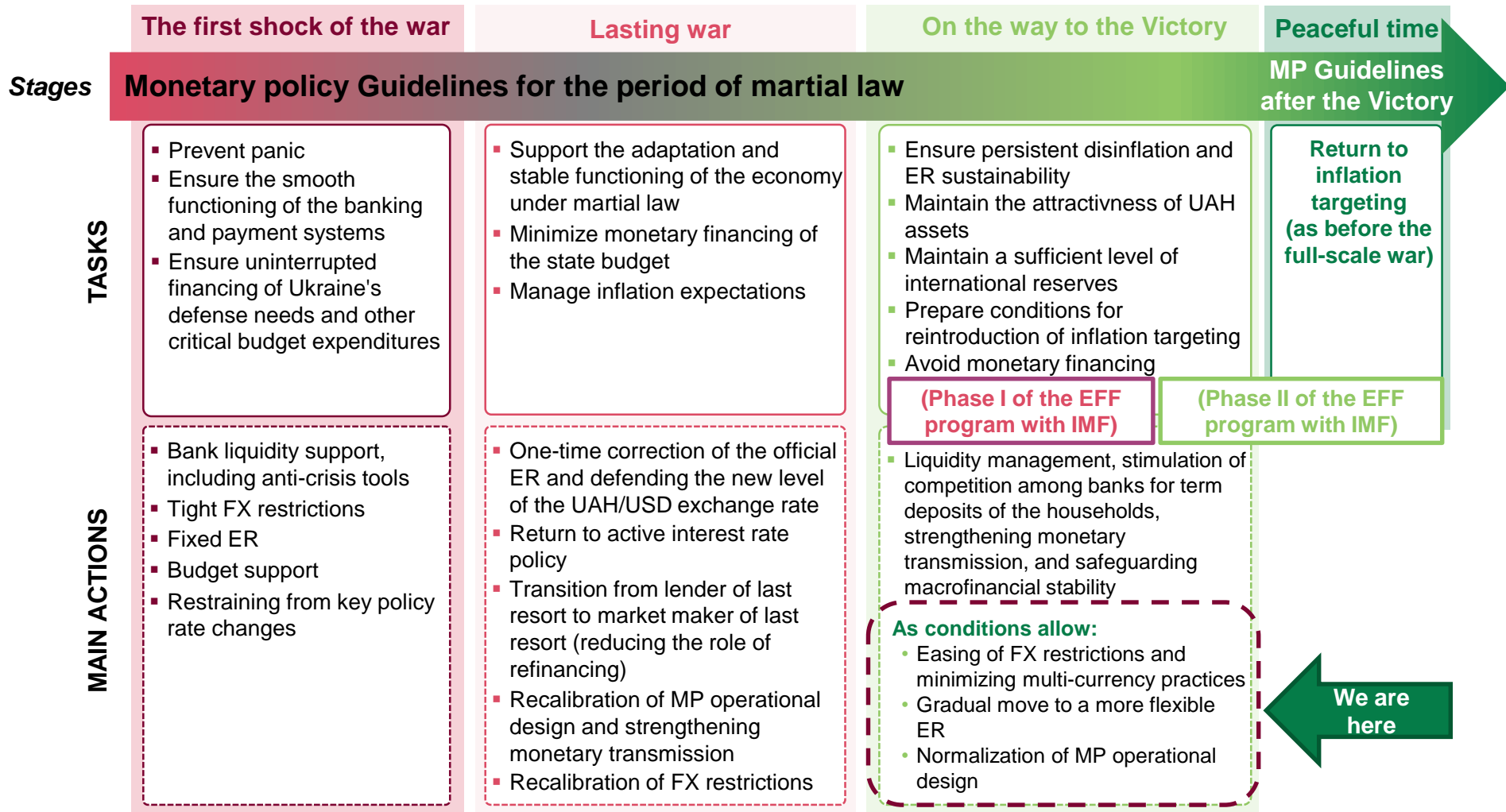
The Resolution also imposes temporary restrictions, effective 24 February 2022. Those include measures that:

- suspend the operation of Ukraine's FX market, except for FX sales by customers
- fix the official exchange rate for 24 February 2022
- limit cash withdrawals from client accounts to UAH 100,000 per day (excluding salaries and social benefits), except for businesses and institutions that ensure the implementation of the government's mobilization plans (objectives) and entities that have the NBU's special permission to operate without paying commissions
- prohibit the release of cash from client accounts in foreign currency, except for businesses and institutions that ensure the implementation of the government's mobilization plans (objectives) and entities that have the NBU's special permission

....




These measures aim to ensure the reliable and stable operation of Ukraine's financial system and facilitate the fullest support for activity of the Armed Forces of Ukraine, as well as the smooth operation of critical infrastructure.

The evolution of monetary policy: creating predictability in the fast-changing environment



...in particular key prerequisites for the transition to the next stage of changes in the monetary regime, envisaged in Strategy*, were fulfilled

According to the Strategy, **the transition to the next stage of changes in the monetary regime** will be possible with the formation of appropriate prerequisites, including:

	Precondition	Comments
	1 Sufficient exchange rate flexibility	<ul style="list-style-type: none"> In October 2023, the NBU switched from fixing to managed flexibility of the exchange rate ER dynamics currently has a significant impact on expectations and inflation, so the task of ensuring a stable and controlled situation on the FX market remains relevant The NBU maintains an active presence in the FX market, compensating for the structural deficit of the currency and smoothing out excessive ER volatility. This contributes to bilateral moderate fluctuations of the ER in response to changes in market conditions
	2 A steady decline in inflation to serve as a nominal anchor for expectations instead of the exchange rate	<ul style="list-style-type: none"> The transition to managed ER flexibility has objectively weakened the role of the exchange rate as a nominal anchor of monetary policy At the same time, the slowdown and lasting maintenance of inflation close to the target, improvement of inflation expectations strengthened the role of inflation as a nominal anchor for expectations The NBU publicly announced that MP will be aimed at supporting moderate inflation and steer it towards the target of 5% over the forecast horizon
	3 Restoration of sufficient effectiveness of the key rate to fulfill its role as the main monetary instrument	<ul style="list-style-type: none"> The gradual restoration of the effectiveness of monetary transmission channels contributed to KPR regaining its effectiveness in fulfilling its role as a monetary instrument Contribution from the NBU side included measures to ease FX restrictions (second stage of the Roadmap), adjust the operational design of the interest rate policy, ensure that the bulk of liquidity regulation transactions are conducted at the KPR

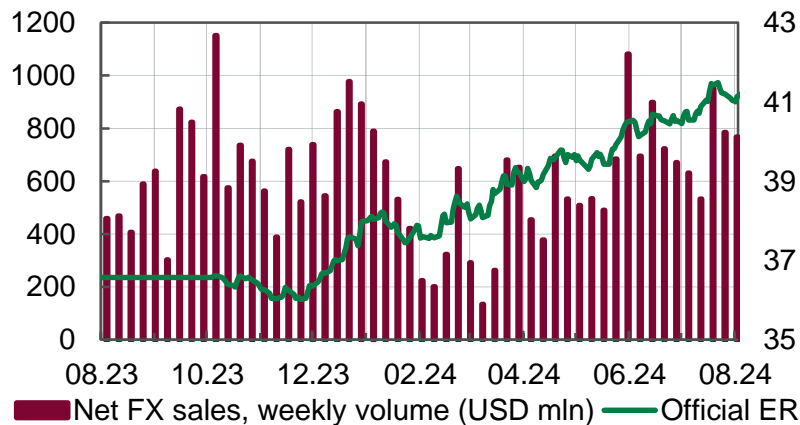
The NBU switched to managed flexibility of the ER for ↑ adaptability of the economy while maintaining control over expectations



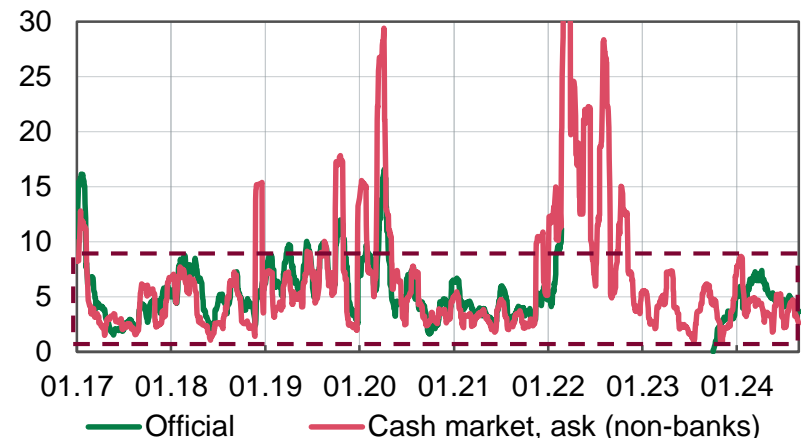
- **Maintaining a stable and controlled situation on the FX market thanks to:**
 - ✓ covering structural deficit of foreign currency
 - ✓ smoothing out excessive ER volatility
 - ✓ minimizing the practice of multiple ERs
 - ✓ interest rate policy measures (in particular, maintaining a sufficient real yield of hryvnia instruments)
 - ✓ calibration of FX restrictions
- **Consistency of ER dynamics with the task of maintaining price stability in the medium term**

- **Ensuring bilateral ER fluctuations** in response to changes in the balance of demand and supply in the FX market
- **The gradual strengthening of the role of the ER as a corrective mechanism for the economy**

The official exchange rate of the hryvnia to the USD and the net sale of currency* of the NBU



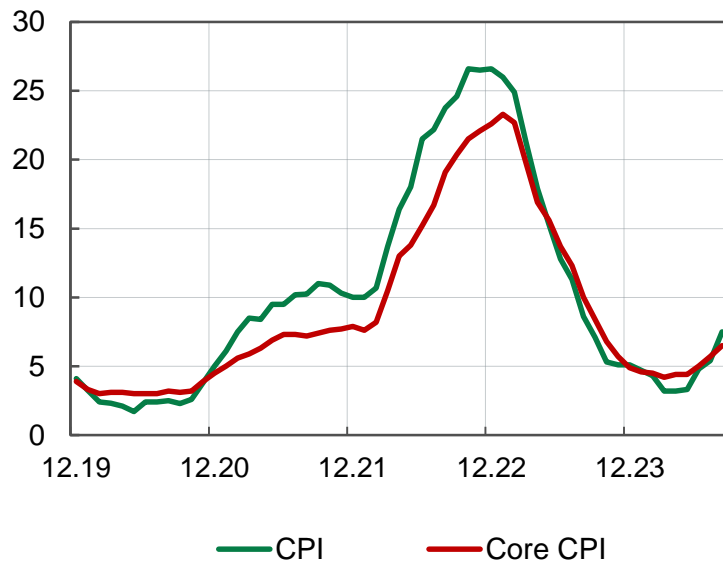
Monthly volatility of the UAH / USD



*Annualized standard deviation of the daily ER change during a rolling month

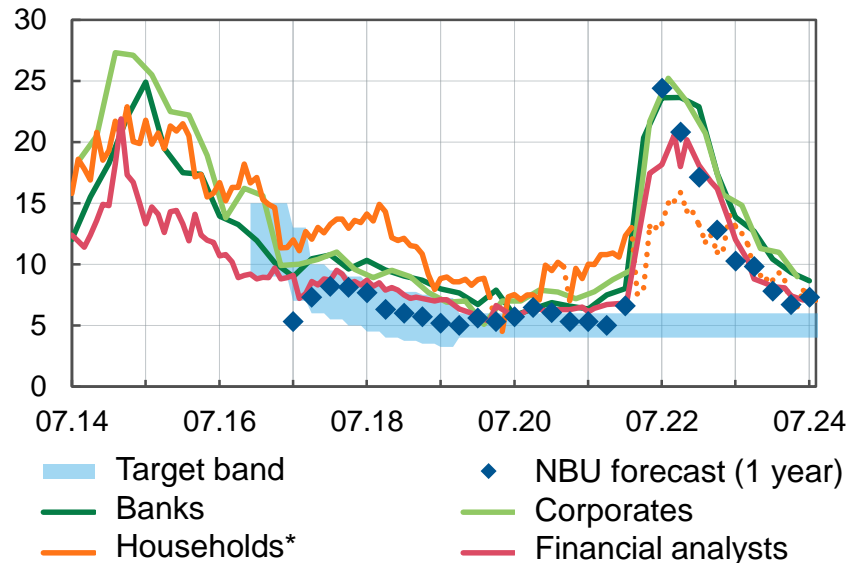
CPI slowing down to the 5% target and improving inflation expectations strengthened the role of inflation as a nominal anchor of MP

CPI and core CPI, % yoy



Source: SSSU.

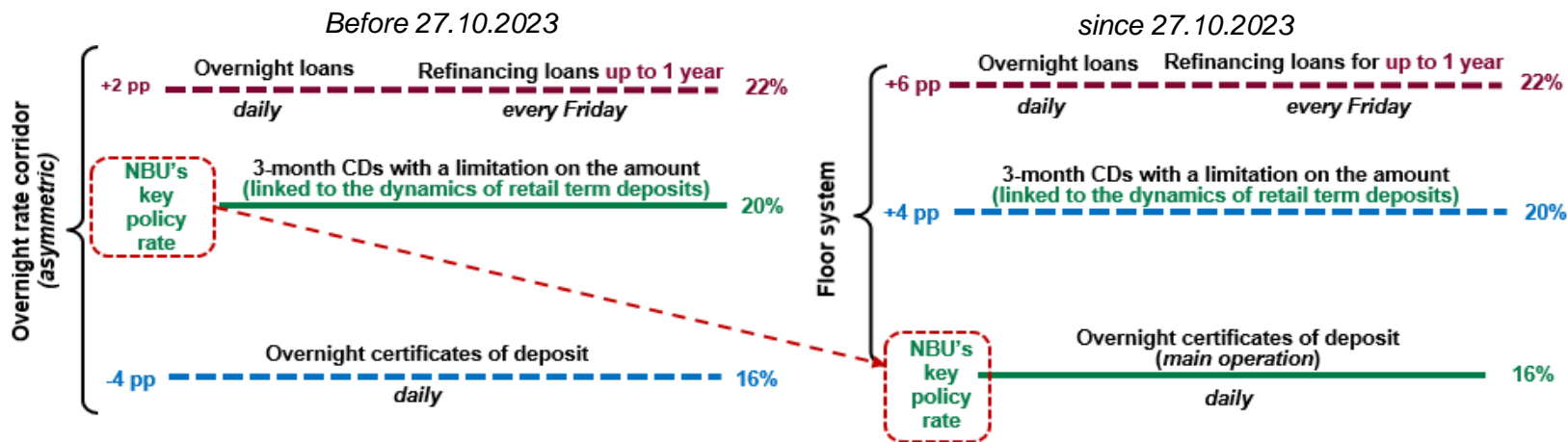
Inflation target, NBU inflation forecast, and inflation expectations for the next 12 months, %



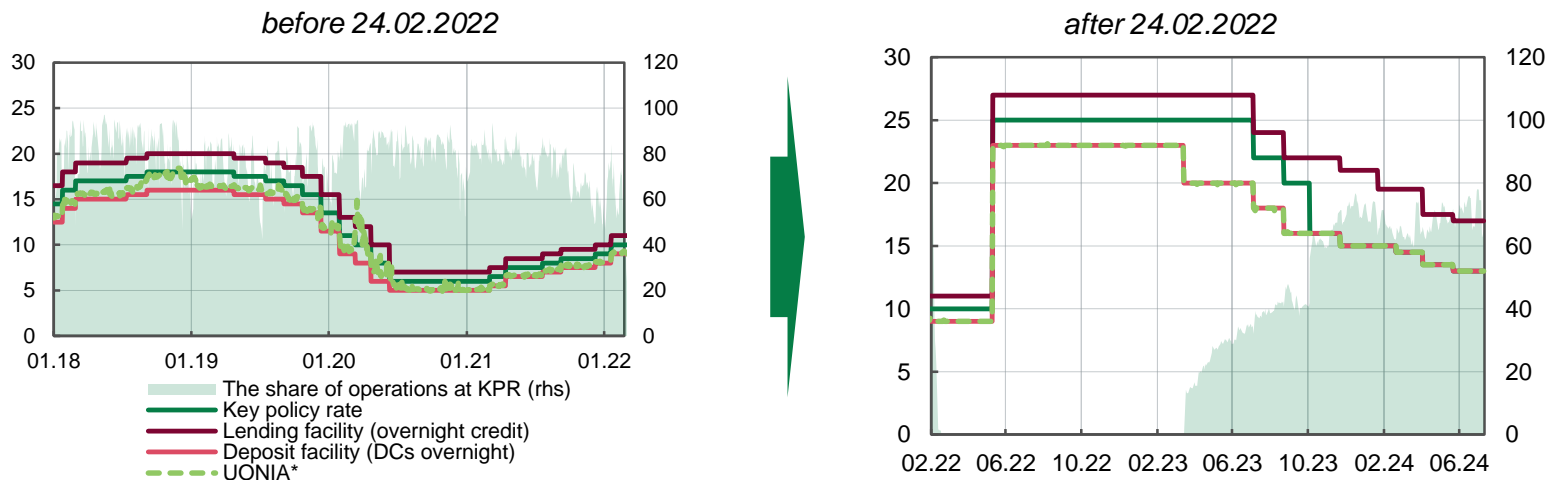
* Dotted lines - change of survey method from face-to-face to telephone interviews.
Source: NBU, GfK Ukraine, Info Sapiens.

Reduction of uncertainty, FX restrictions easing and a set of NBU measures contributed to the restoration of transmission channels...

Operational framework of the NBU's interest rate policy



NBU's interest rate corridor, UONIA, and the share of operations at the key policy rate, %



* UIIR - before 22.06.2020.

Source: NBU

...so in line with the Strategy the NBU de facto moved to the interim monetary regime – flexible IT (the naming of IT lite regime)

Monetary regime of flexible inflation targeting

Principal features

- existence of point quantitative inflation target (without band)
- application of a consistent combination of tools of key policy rate, FX and exchange rate policies (managed flexibility of ER), as well as FX restrictions for achieving the target
- prolonged policy horizon

Monetary policy goal

Monetary policy will be aimed at bringing inflation measured by annual CPI to the **5% target** over the **appropriate policy horizon**
! *Under conditions of uncertainty and high volatility of inflation the efforts to communicate deviation band from the target of +/- 1pp would complicate anchoring of expectations*

Exemption clause

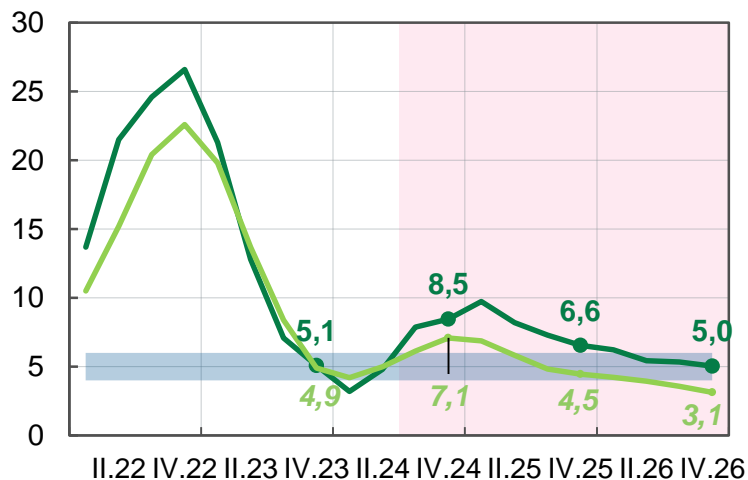
In certain periods **inflation may deviate from the target** due to internal and external factors, which are outside of effective monetary policy influence of the NBU. The policy horizon will be flexibly determined taking into account the need to balance between **facilitating the adaptation of the Ukrainian economy to shocks and maintaining its recovery**, on the one hand, and **maintaining control over inflationary expectations** - on the other

Will promote the adaptation of Ukraine's economy to domestic and external shocks while preserving control over inflation expectations

! **NBU will aptly adapt its monetary policy in the case of significant unexpected changes** in actual dynamics of macroeconomic indicators and in the balance of risks for inflation, sustainability and controllability of the situation on the FX market and economic development on the forecast horizon

NBU's policies will support moderate inflation, while the economy continues to recover

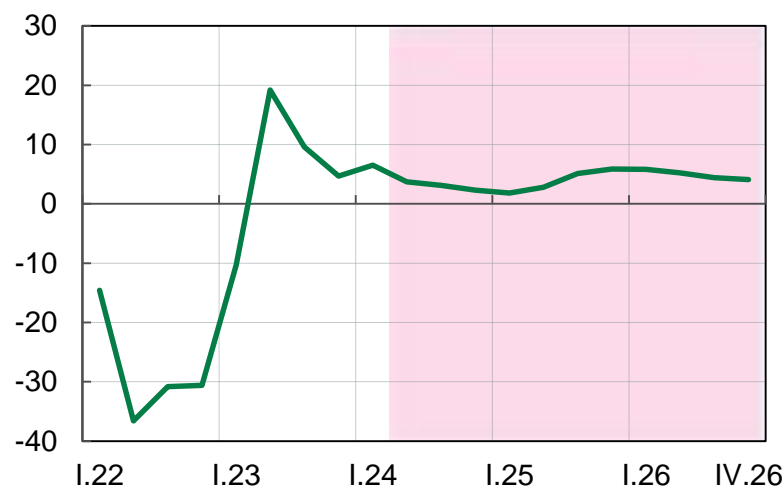
Inflation, yoy, %



— CPI target band — CPI — Core CPI

Source: SSSU, NBU staff estimates.

Real GDP, %

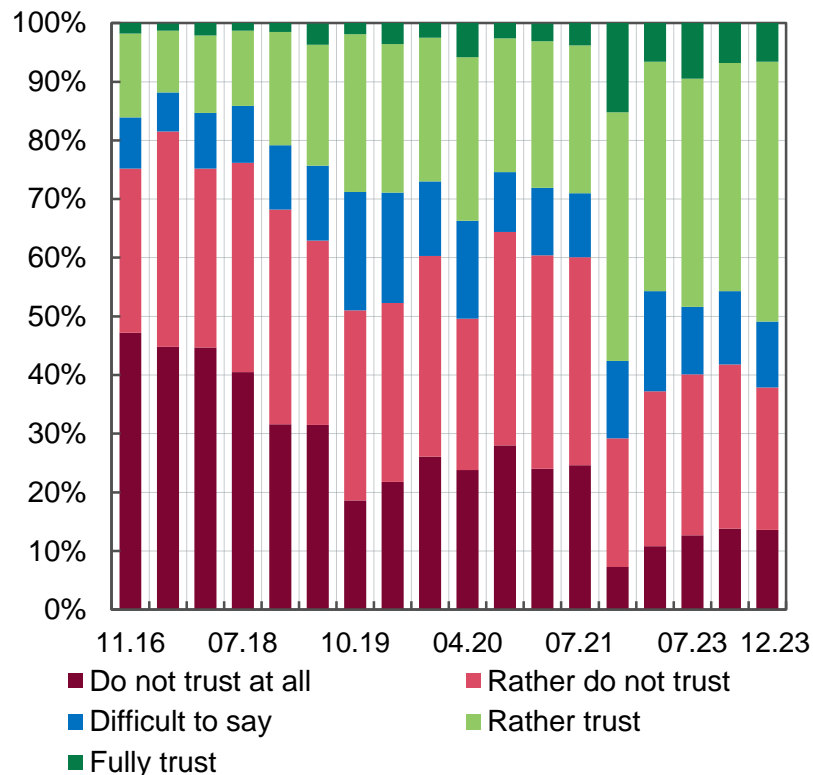


Source: SSSU.

- In 2023, inflation slowed markedly, including thanks to the NBU's consistent monetary policy. **The achievement of moderate levels of inflation makes it possible to strengthen its role as a nominal anchor**
- Despite the expected acceleration of inflation in 2024, it will remain moderate and will return to the target range of 5% ± 1 pp over the monetary policy horizon due to the NBU's measures to maintain exchange rate sustainability, the attractiveness of hryvnia asset, and decline in security risks
- **Real GDP** returned to growth (5.3% in 2023 after the decline by 28.8% in 2022). Resilience of the Ukrainian economy and the persistent adjustment of businesses and households to wartime conditions, stable energy supply, rebound in domestic demand, record-high yields, faster expansion of alternative export routes, and substantial budget support are the main drivers

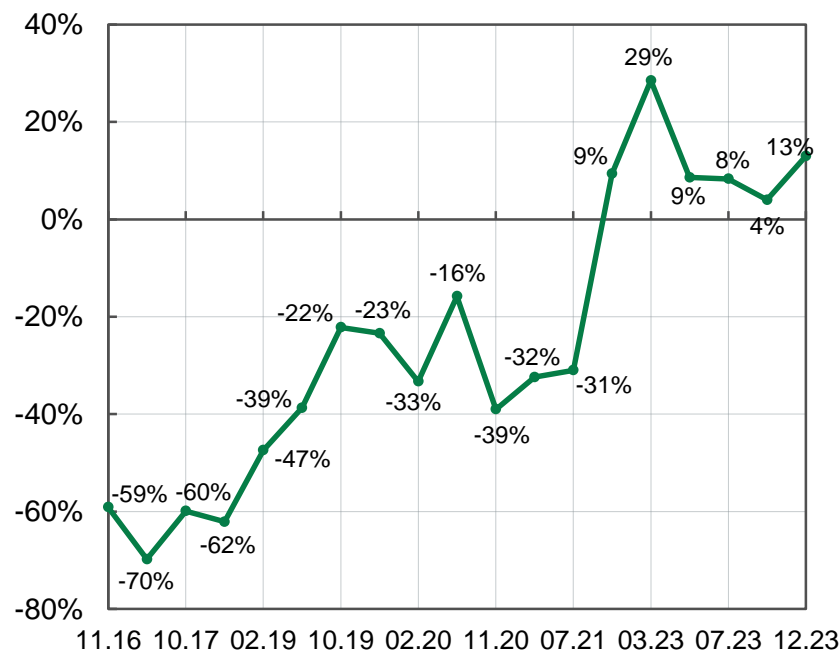
Credibility is the most valuable resource for the central bank

The level of public confidence in the NBU



Source: [Razumkov Centre](#) sociological studies

Trust-mistrust balance*



*Difference between **share of those who trust** and **share of those who don't trust it**

Source: [Razumkov Centre](#) sociological studies

- Despite a full-scale war trust-mistrust balance for the NBU became positive

Key achievements so far

Despite Russia's full-scale invasion and terrorist attacks, **the financial system and the NBU are operating well and supporting Ukraine's defense needs**

The hryvnia continues to perform its monetary functions. Ukraine has managed to avoid the worst-case scenario: a demonetization of the economy

NBU's commitment to its mandate to ensuring price and financial stability **paid off.** Macrostability is crucial for the country's defense capability under the martial law and for the subsequent rapid recovery

NBU applied a mix of traditional instruments (ER sustainability, recalibration of capital controls) and **unconventional tools** (unconventional operational design, instruments for households to hedge against FX risks etc) to achieve its targets

The NBU managed to strengthen MP transmission to deposit rates and encouraged competition among banks for depositors' UAH savings, **keeping UAH assets attractive.** That allowed to decrease speculative motives among FX market participants and minimize FX interventions

The NBU keeps moving forward along the `Strategy for easing FX restrictions, transition to greater exchange rate flexibility and return to inflation targeting`



National Bank of Ukraine

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