Національний банк України

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MONEY AND FOREIGN EXCHANGE MARKETS CONTACT GROUP

Wednesday, 29 March 2023, 11 a.m. - 1 p.m.

The meeting took place in remote mode via Zoom.

Discussion Summary

Issue 1. Money and FX market's operation during full-scale war

*(speaker: **Oleksandr Arseniuk**, Head of the Office for Operative Regulation of the Money Market of the Open Market Operations Department).*

The speaker presented an overview of the money market's and the FX market's operation during the full-scale war. The overview focused on problems in their functioning and structural shifts that had occurred in the markets compared to their pre-war operation.

Specifically, the speaker drew everyone's attention to the banks' negligible activity in the ***money market***. The lack of activity is adversely affecting the work of the monetary transmission mechanism and essentially eliminating the market-based component in the calculation of UONIA, making this indicator largely prescriptive. Money market transactions in wartime have all but died down due to the continued galloping growth in the structural surplus of liquidity and the elevated riskiness of such transactions as the war grinds on.

The ***FX market's*** operation during the war has also sustained significant changes. In particular, although the NBU has imposed significant FX restrictions, the market has lost its ability to self-balance and is now heavily reliant on the central bank's daily interventions. Under martial law, a significant part of foreign currency has been coming into Ukraine's government accounts via official channels. The government then sells it outright to the NBU, bypassing the market. The FX supply is therefore failing to meet FX demand in the market, creating the need for the NBU's daily interventions.

The speaker pointed out that FX demand has been steadily surpassing FX supply in client transactions even though – with capital transactions having been severely restricted – almost all wartime FX purchases and transfers from Ukraine are taking place to pay for imports. At the same time, since the war broke out, the banks' own transactions have also been generating significant net FX demand as clients make card-based purchases outside Ukraine. Before the war, this factor was barely felt and had little to no impact on market conditions.

The official exchange rate during the war has been fixed. The exchange rates in the banks' transactions with clients (except for card-based and cash transactions) have been tied to the official exchange rate. Because of FX restrictions, the spread between cashless and cash rates is much wider than in pre-war times, although it has recently been narrowing rapidly.

The discussion centered on the feasibility and effectiveness of certain temporary FX restrictions. Especially actively discussed were the restrictions on transactions with russian and belarusian rubles. Although the blocking of the vast majority of ruble-denominated transactions looks understandable politically, it is rather dubious from an economic perspective, as it deprives businesses of access to their funds, the Contact Group members pointed out. An optimal solution would be to enable Ukrainian banks to make "wrap-up" transactions with rubles by converting them into other currencies in the global market and closing all correspondent accounts in these currencies, bank representatives said. NBU representatives informed them that the NBU continues to look for the best way to resolve this issue.

Among other things, the participants expressed their preferences regarding the introduction of identical approaches to the regulation of the banks' and NBFIs' transactions with FX domestic government debt securities, and the unification of the regulation of retail trade in FX cash and investment metals.

NBU representatives said that these issues can be considered within the framework of a roadmap to ease FX restrictions that is being developed by the NBU as part of a new program with the IMF. The roadmap will be aimed at bringing the regulation of the FX market back to where it was before russia launched the full-scale invasion.

Issue 2. New operational design of monetary policy: purpose, action mechanism, expected results

*(speaker: **Mykhailo Rebryk**, Head of the Monetary Policy Office of the NBU Monetary Policy and Economic Analysis Department)*

The speaker presented the changes made by the NBU after the Monetary Policy Committee's March meeting on money market regulation. The presentation focused on the features of the new operational design of monetary policy. The new design is effective from 7 April 2023.

Specifically, the speaker said that although the NBU has made visible progress in achieving its monetary policy goals (decreased inflation, improved FX market conditions, positive changes in how the monetary transmission mechanism operates), inflationary pressure and expectations remain elevated, and deposit interest rates are still not high enough to offset the current and expected pace of inflation. As a result, households are choosing to keep their money in current accounts, which poses additional risks to macrofinancial stability and impedes the emergence of prerequisites for a gradual rollback of FX restrictions.

At the same time, the speaker emphasized that the new operational design of monetary policy will have a distinguishing feature: the interest rate on overnight certificates of deposit (CDs) will be reduced to 20% from 23%, and weekly tenders will be introduced to place three-month CDs at the key policy rate. The maximum investment by banks into three-month CDs will be calculated as a part of at-least-three-month hryvnia retail deposits plus an increase in such deposits times a multiplier.

The speaker underlined that the adjustment of the operational design and the more detailed differentiation, by maturity, of reserve requirement ratios for retail deposits will boost the banks' market-based incentives for raising hryvnia term deposits and ease FX market risks that may arise with the loosening of FX restrictions. In particular, interest rates on term deposits will increase further, the key policy rate will become a more effective tool of monetary policy, and the development of a culture of savings among households will accelerate.

During the discussion, individual members of the Contact Group voiced their perspective on the potential viability of expanding the CD line, including by introducing 7-day and 14-day CDs, a step that would make the banks more flexible in managing their free liquidity. In response, NBU representatives explained that the new operational design is primarily aimed at incentivizing the banks to more actively draw in three-month retail deposits to reduce risks to macrofinancial stability. If one-week and two-week CDs were to be made available, such incentives would be considerably weakened and the risks would remain significant. At the same time, the configuration of the operational design would become even more complicated.

The bankers also drew the attention of NBU representatives to the fact that changes in the operational design are creating greater incentives for the banks to attract retail term deposits with a maturity of exactly 3 months, not longer. At the same time, this effect does not eliminate the fact that the profitability to the banks of attracting less-than-three-month deposits stands to noticeably decline.

List of participants

Chair of the Contact Group Yuriy Heletiy	− National Bank of Ukraine
Co-Chair of the Contact Group Oleksii Lupin	− National Bank of Ukraine

Members of the Contact Group:

Maksym Abrosimov	– A-BANK JSC
Alla Brovkova	– Oschadbank JSC
Andrii Varzar	– Pivdennyi Bank JSC
Oleksii Dmytriiev	– UNIVERSAL BANK JSC
Oleksandr Duda	– UKRSIBBANK JSC
Maksym Dumanskyi	– BANK FOR INVESTMENTS AND SAVINGS PJSC ЗАОЩАДЖЕНЬ”
Andrii Dutskyi	– BANK VOSTOK PJSC
Oleksii Yefremov	– UKRGASBANK JSB
Oleh Klimas	– Raiffeisen Bank Aval JSC
Anton Kovalenko	– CB PrivatBank JSC
Serhii Kucheriavyi	– KREDOBANK JSC
Stanislav Lysianskyi	– BANK ALLIANCE JSC
Viacheslav Ozerov	– CREDIT AGRICOLE BANK JSC
Vladyslav Pariokha	– TASCOMBANK JSC
Liudmyla Pylypiv	– PROCREDIT BANK JSC
Andrii Potapov	– ING Bank Ukraine JSC
Anton Stadnyk	– FUIB JSC
Rostyslav Shapoval	BANK 3/4
Andrii Shpylevskyi	– OTP BANK JSC

Invited participants:

Oleksandr Arseniuk	− National Bank of Ukraine
Tetiana Yerlina	− National Bank of Ukraine
Iryna Zhak	− National Bank of Ukraine
Anna Zakrenychna	− National Bank of Ukraine
Volodymyr Lepushynskyi	− National Bank of Ukraine
Maryna Matviienko	− National Bank of Ukraine
Sergiy Nikolaychuk	− National Bank of Ukraine
Mykola Selekhman	− National Bank of Ukraine

Kateryna Semenchenko − National Bank of Ukraine