COUNCIL
OF THE NATIONAL BANK OF UKRAINE

MONETARY POLICY GUIDELINES

FOR 2018 AND

THE MEDIUM TERM

Approved by Decision of the Council of the National Bank of Ukraine of 12 September 2017

Kyiv, 2017

Introduction

The Council of the National Bank of Ukraine (the NBU Council) developed the Monetary Policy Guidelines for 2018 and the Medium Term (hereinafter the Policy Guidelines) per Article 100 of the Constitution of Ukraine and Articles 8, 9, and 24 of the Law of Ukraine *On the National Bank of Ukraine* based on proposals from the NBU Board.

The Policy Guidelines have been prepared in consideration of Articles 1 and 6 of the Law of Ukraine *On the National Bank of Ukraine*, the Strategy for Sustainable Development "Ukraine – 2020, the economic program objectives pursued under the Extended Fund Facility (EFF) arrangement with the International Monetary Fund (IMF), the Forecast of Economic and Social Development of Ukraine for 2018-2020, the NBU's macroeconomic forecast, and the Government's Mid-Term Action Plan for Priority Measures until 2020.

The Policy Guidelines take into account current trends in global markets, their effect on the Ukrainian economy, the specific nature of the NBU's functions and the methods the central bank applies in performing those functions, as well as macroeconomic indicators, contingency risks, and general approaches to their mitigation. The Policy Guidelines also specify quantitative and qualitative parameters for the NBU's monetary policy for 2018 and the medium term for implementing the regulator's goals and functions.

Given the importance of consistency in monetary policy as a prerequisite for fostering trust in the hryvnia, the key policy components from last year's Monetary Policy Guidelines for 2017 and the Medium Term have remained unchanged.

Based on the current trends in monetary policies, particularly a shift in the emphasis towards a wider array of monetary regulation issues being covered by the monetary policy, the wording "грошово-кредитна (монетарна) політика" in the Ukrainian version of the Monetary Policy Guidelines is used instead of "грошово-кредитна політика", with both terms rendered as "monetary policy" into English.

The NBU Council deems it expedient to initiate amendments to the Ukrainian legislation as regards replacing the words "грошово-кредитна політика" with "монетарна політика" (monetary policy), as well as developing the medium-term monetary policy strategy.

Monetary policy comprises a set of measures related to cash circulation and credit aimed at ensuring the stability of the Ukrainian currency through the use of appropriate tools and methods.

According to Article 99 of the Constitution of Ukraine, the NBU's primary goal is to ensure the stability of the Ukrainian currency.

According to Article 6 of the Law of Ukraine *On the National Bank of Ukraine*, in pursuing its primary objective, the NBU shall prioritize achieving and maintaining price stability in the country.

Price stability means the retention of purchasing power of the domestic currency by maintaining low and stable rates of inflation as measured by the Consumer Price Index (CPI) over the medium term (from 3 to 5 years).

The NBU, acting within the framework of its authority, also promotes financial stability, including the stability of the banking system, without compromising its primary objective of price stability.

The NBU also facilitates sustainable economic growth and supports the economic policies pursued by the Cabinet of Ministers of Ukraine, provided they do not contradict the regulator's goals of price and financial stability.

The NBU Board uses appropriate tools and methods to ensure the implementation of monetary policy in accordance with the Policy Guidelines and the board is responsible for achieving the objectives outlined in the Policy Guidelines.

The NBU Council supervises the implementation of monetary policy as outlined by Article 100 of the Constitution of Ukraine.

I. The NBU's Priority Functional Areas

1.1. Price Stability is the Priority Objective of the NBU's Monetary Policy

Low and stable inflation is the main requirement for a country's sustainable economic growth and financial development; the central bank is tasked with delivering that objective.

An improvement in the macroeconomic environment relies on expectations of low inflation, which is also a key factor in the fostering of Ukraine's economic potential.

The mid-term target for inflation is set at 5% ± 1 pp (annual growth in the CPI) over the period of 2018-2020.

The mid-term inflation target is higher than typical for developed countries, but in-line with target levels in emerging market countries. The mid-term inflation target has been set at 5% taking into consideration Ukraine's history of high and volatile inflation with wider inflationary shocks. As progress is made in achieving the mid-term inflation target of 5%, the target level can be revised downwards to allow a further reduction of nominal interest rates.

The path for annual changes in CPI, guiding a gradual downward trajectory of inflation to the mid-term target, was announced in the Policy Guidelines for 2017 and the Medium Term, and remains unchanged:

December 2018: 6% ±2 pp

December 2019: 5% ±1 pp

December 2020: 5% ±1 pp

The gradual reduction of inflation to the 5% target reflects the need to mitigate the short-term negative effects stemming from a sharp drop in inflation on the back of the economic recovery and employment.

The inflation targets are established in annualized terms for December of the respective year. The following quarterly trajectory for annualized CPI growth has been established for the achievement of the relevant inflation targets:

March 2018: 7.5% ±2 pp

June 2018: 7% ±2 pp

September 2018: 6.5% ±2 pp

March 2019: 5.75% ±2 pp

June 2019: 5.5% ±2 pp

September 2019: 5.25% ±2 pp

As of December 2019, the NBU will work to ensure that the medium-term inflation target of 5% ±1 pp is sustained (annualized CPI growth), and not only achieved as of the year-end.

The NBU expects that an improvement of inflation expectations by economic agents, a weakening of the effect of the FX rate and producer prices on inflation, a reduction of the seasonality of specific CPI components, and a lower share of administered prices to be revised upwards, will contribute to achievement and maintenance of inflation at the target level.

Maintaining inflation within the target range will help improve expectations and enhance the transparency of the NBU's actions. In turn, this will allow interest rates to more accurately reflect inflation risks and allow interest rates to continue declining. The predictability of inflation and reduction of the inflation risk premium will further the development of the credit market and facilitate borrowing for investment purposes.

Once announced, the inflation targets for 2018-2020 cannot be modified. The fixed targets will increase confidence in the NBU's monetary policy and the inflation-targeting approach, in contrast to an approach based on adjustments to short-term deviations in inflation. In the future, as Ukraine's economy grows, the medium-term inflation targets can be revised downwards. The further trajectory of the inflation targets will be determined based on an assessment of inflation risks and the need to maintain stable economic growth and financial stability in the country.

In analyzing inflationary trends, the NBU will consider other indicators of inflation, including the GDP deflator and the Producer Price Index (PPI). The analysis will examine sources of growth in the PPI and their actual and potential impact on consumer prices. The NBU will rely on the core inflation rate to assess the inflationary pressure that stems largely from monetary conditions. Core inflation is more resilient to the external and internal shocks that are beyond the scope of monetary policy, particularly food supply factors and administrative tariffs.

The NBU’s efforts to prevent additional disinflation losses in the event of unexpected shocks to high-volatility components of CPI do not imply that the core inflation reading is the dominant factor in making a decision on the central bank’s key policy tool. Since food accounts for a significant proportion of consumption, excessive volatility in food prices can affect purchasing power and domestic demand, and worsen inflation expectations.

The regulator will use the flexibility of the inflation-targeting regime not only to bring inflation closer to the target, but also to consider the influence of monetary decisions on economic growth. In the short-term, inflation may deviate from the established targets owing to external and internal shocks that are beyond the scope of monetary policy. Examples of these types of shocks include fluctuations in commodity prices and other volatile components of CPI, deviations of administered prices from previously announced levels, etc. In this regard, monetary policy measures will be aimed at preventing the impact of the second-round effects of these events on inflation expectations and at bringing inflation closer to the established targets over time, while contributing to price stability over the medium-term.

1.2. Promoting Financial Stability

Financial stability denotes the condition under which the financial system is able to effectively perform its key functions, such as financial mediation and payment processing, to foster sustainable economic growth and protect the economy from the adverse effects of crises.

While working to maintain financial stability, the NBU will support the stability of Ukraine’s financial sector and its segments, ensure the effective redistribution of resources by the financial system, help market participants assess and perceive risks appropriately, boost the financial system's resilience, and reduce the probability of systemic crises.

The NBU will meet its objective of promoting financial stability by conducting micro- and macroprudential regulation and supervision.

The NBU develops macroprudential policy that identifies and assesses systemic risks to financial stability, and enacts preventive measures to minimize those risks through the use of appropriate tools.

The central bank constantly monitors the overall stability of the financial system, using quantitative and qualitative indicators, models, and professional judgments to assess risks.

The NBU will employ capital buffers and other macroprudential policy tools to smooth out cyclical fluctuations and to mitigate negative externalities, such as undue growth in debt and concentrations of risks. To decrease dollarization in the economy, the central bank will also consider introducing additional economic requirements for banks.

Adopting risk-based supervision is an important step in bolstering macroprudential regulation. This process, which was started in 2016, aims to make overall banking supervision more effective and further coordinate the NBU's micro- and macroprudential measures and actions.

The NBU will use monetary tools to reduce the impact of shocks on Ukraine's financial system. To stabilize expectations and to address market disruptions during financial turbulences, the central bank will, among other things, act as the lender of last resort. The NBU will use the key policy rate and interventions in the FX market as additional tools.

The NBU will continue to initiate changes to legislation to enhance the protection of creditors' and depositors' rights, improve corporate governance, promote fair competition in the financial sector, make supervision more effective, encourage cashless payments, and introduce other measures as outlined in the Comprehensive Financial Sector Development Program to run until 2020.

With the purpose of achieving financial stability, the NBU will continue to work closely with the Ukrainian government and other regulators, especially via the Financial Stability Board.

The NBU believes that enhancing the financial soundness of both the banking system and individual banks and decreasing related-party lending to a level where it does not pose a threat to the operation of banks and the banking system needs to be a priority.

1.3. Maintaining sustainable economic growth and supporting the government's economic policy

Creating an environment with low and stable inflation is the NBU's main contribution to sustainable economic growth. Meeting the established inflation targets will help the economy achieve the projected annual rates of real GDP growth: accelerating to 3% in 2018 and reaching its potential level of 4% in 2019.

Sustainable economic growth means that annual changes in real GDP do not deviate significantly from the mid-term path. The NBU will promote sustainable economic growth and prevent an accumulation of macroeconomic imbalances, adjustments of which negatively affect the country's economic potential. Maintaining price stability is the best approach to ensuring sustainable GDP growth as it eliminates unpredictable and subjective decisions on changes to monetary policy. Pursuing a policy of price stability also increases competition in the market, which leads to increased investment and innovation. Price stability is a fundamental prerequisite for financial deepening and a reduction in long-term interest rates.

Ensuring sustainable economic growth, carrying out structural economic reforms, improving the availability of credit, and attracting long-term investment requires a greater coordination of monetary and fiscal policies.

Since sustainable economic growth is impossible without the successful implementation of reforms, the NBU and the government will make every effort to continue enacting economic and financial reforms, including those required by international financial institutions.

The NBU will seek to facilitate coordination between monetary policy and the government's economic and fiscal policies since those policies are interconnected and there is a direct link between monetary policy, real output, the financial system, and the balance of payments.

Improved coordination between the policies will speed up the elimination of the economy's structural and cyclical imbalances, enhance financial soundness, and improve the economy's ability to mitigate the negative effects of external and internal shocks. All these are important factors in strengthening Ukraine's currency.

While delivering foreign exchange and banking stability, the NBU will support the effective operation of key elements of the money market, such as the foreign exchange and credit markets.

II. The monetary policy regime and monetary policy principles

The NBU will remain committed to inflation-targeting. The NBU's main objective is to ensure national currency stability by delivering and maintaining price stability in the country. The hryvnia's purchasing power is maintained by keeping inflation low and stable over the mid-term (three to five years), as measured by the CPI. This will help the economy achieve the mid-term real GDP growth rates that are projected by the NBU and the government.

To meet all of its objectives, the NBU will be guided by the following principles of monetary policy:

Delivering and maintaining price stability as a priority

Commitment to a floating exchange rate

Making forward-looking decisions based on macroeconomic framework to foster economic growth Monetary policy decisions will be guided by comprehensive macroeconomic analyses and forecasts

Maintaining the NBU's institutional, financial, and operational independence to enable the central bank to execute its functions

Being transparent in its operations and accountable for its actions. To stabilize inflation and exchange rate expectations and to meet its priority objective, the NBU will pursue a consistent and transparent monetary policy and will be accountable for its policy decisions.

The NBU will regularly inform the public on compliance with these guidelines, providing detailed explanations for the nature, reasons, and expected effects of proposed or taken actions. If an inflation target is missed, the NBU Board will explain to the NBU Council the reasons for the underperformance and inform it of actions it has taken or is proposing to take to bring the inflation back on-target.

The NBU will report to the president of Ukraine and Verkhovna Rada of Ukraine regarding money market conditions and other monetary developments.

III. Monetary Policy Tools and Methods and the Specifics of their Use

Key policy rate Achievement of the objectives outlined in these guidelines requires flexible application of the NBU's monetary tools and methods.

To meet its inflation targets, the NBU will use the key policy rate as its main monetary tool. The rate is set by decision of the NBU Board and reflects the monetary policy stance. The rate is also used as the basis for short-term interest rates on the interbank credit market.

When making a decision on the key policy rate, the NBU takes into consideration actual and projected inflation rates. If the projected inflation rate is higher than the target level, the NBU will tighten its monetary policy to bring the projected rate back in-line with the target. If inflation is projected to be lower than the target, the NBU will ease monetary policy. These actions are aimed to bring inflation back to the target level over the mid-term. Under these conditions, the NBU will maintain its key policy rate positive in real terms relative to expected inflation.

Other interest rates. While managing short-term interbank interest rates, the NBU will set a band for interest rates on standing facilities (overnight loans and overnight certificates of deposit). Interest rates on overnight loans and certificates of deposit are used as the cap and the floor of the band, which prevents short-term interbank interest rates from deviating materially from the key policy rate. The cap and the floor of the interest rate band will be set symmetrically to the key policy rate.

Other tools. To manage liquidity, the NBU will also use other monetary tools that will play a secondary role in managing interbank interest rates and will contribute to the development of financial markets. These tools include:

Refinancing tenders and tenders for the issuance of the NBU's certificates of deposit with different maturities, repos, FX swaps, and sales and purchases of securities

Required reserves. The central bank will use this tool to manage liquidity and to increase the influence of changes in the key policy rate on interbank interest rates. To make liquidity management more effective and to encourage banks to attract mainly hryvnia-denominated deposits and for longer terms, the NBU may choose to impose different reserve requirements.

Refinancing for banks. The NBU will enhance its liquidity support tools with the goal of creating an environment conducive to lending that will fuel economic growth. The focus of this work will be on enhancing the ability of financial institutions and their customers to properly manage risks arising from financial projects. With the purpose of hedging risks related to changes in liquidity conditions over the mid-term, the NBU may hold variable rate tenders to provide refinancing at a floating rate for up to five years. The tenders will be transparent and will offer equal access to the refinancing opportunities. Since the refinancing rate will be based on the key policy rate, these operations will also increase the effectiveness of the interest rate channel of the monetary transmission mechanism.

These tools will increase the banking sector's potential to provide loans to the real economy, especially to small, medium, export-oriented, import-substituting, and hi-tech companies.

Once inflation risks subside, the NBU will decrease the volume or interest rate on its mobilization operations to boost lending and speed up economic growth.

To prevent monetary risks related to demand inflation, the NBU will also factor in developments in the monetary aggregates when making monetary policy decisions.

Exchange rate policy The exchange rate policy will support the NBU's efforts to achieve its priority objective. To that end, the NBU will maintain a floating exchange rate –monetary policy will not aim to ensure a fixed exchange rate level or band.

In pursuing its exchange rate policy, the NBU will be mindful of the link between inflation and fluctuations in the exchange rate and that changes in the exchange rate affect financial stability.

The NBU's task is to deliver the right conditions for a well-functioning, liquid, and flexible foreign exchange market that can independently restore its equilibrium and absorb shocks. As the foreign exchange market improves its functioning, the NBU will gradually decrease its activity by reducing the frequency of interventions and relaxing administrative restrictions.

The NBU will intervene in the foreign exchange market to:

Accumulate international reserves

Smooth out exchange rate fluctuations

Support the transmission mechanism of the key policy rate as the main tool of monetary policy.

Increasing international reserves is another mid-term priority.

The amount of and changes in international reserves shape the expectations of FX market participants because reserves can be used to smooth out peak increases in the exchange rate, thus delivering a stable exchange rate of the hryvnia over the mid-term. A sufficient level of international reserves will serve as a safeguard for the financial system and the economy by offsetting the effects of external shocks.

Under certain conditions, the objectives of delivering price stability and accumulating international reserves may be mutually incompatible. In this event, price stability will be given priority.

Price stability and a flexible exchange rate are fundamental preconditions for a decrease in the dollarization level and an increase in financial stability and the effectiveness of the monetary transmission mechanism.

To meet its priority objectives, the NBU will use all available monetary tools and methods, including capital import and export controls, requiring businesses to sell a portion of FX earnings, changes to the settlement period for exports and imports of goods, and more.

IV. Monetary Policy Environment

External Macroeconomic Environment Under the NBU's baseline scenario, global economic growth is projected to accelerate in 2018-2020, buoyed by a recovery in consumption and investment demand against the backdrop of favorable financial conditions and a rebound in global trade. Developed economies are projected to grow on average 1.7%-1.9% and developing markets will grow 4.1%-4.7%. The pace of expansion will continue to be highest in Asian countries thanks to high domestic demand. The IMF and the OECD are forecasting global GDP growth of 3.6% in 2018.

An acceleration of the global economy will gradually push prices for global commodities higher, which will benefit Ukrainian exports. Prices for ferrous metals will remain high on the back of stronger demand and the introduction of anti-dumping duties by some countries. Global grain prices, especially wheat and corn, will grow slowly as production output is expected to fall from the record highs of previous years. This will be driven by a partial shift to the production of more-profitable soya. Consumption of grain will remain stable, primarily owing to North Africa and Asia.

Inflation will gradually rise and approach established targets in developed countries. Conversely, inflation will decrease to meet target levels in developing economies.

This will gradually normalize monetary policy: rates will grow in developed countries and decline in developing markets. These changes may influence capital flows by creating both new opportunities for external borrowing and additional difficulties related to changes in risk attitudes.

Global financial conditions are expected to be sufficiently favorable to allow Ukraine to access international capital markets.

Internal Macroeconomic Environment Ukraine's economy will recover after the crisis thanks to continued structural reforms, an acceleration of global economic growth, improved terms of trade, and a gradual resumption of bank lending. Per the government's macroeconomic forecast, Ukraine's GDP growth will accelerate to 3.0% in 2018, 3.6% in 2019, and 4.0% in 2020. Under the NBU's baseline forecast, GDP will accelerate to 3.2% in 2018 and reach its potential level of 4% in 2019.

The growth in GDP will be driven by a further recovery of consumer and investment demand as household consumer confidence and business investment sentiment improve. The main factor behind the expected increase in consumer demand will be an increase in wages as high labor mobility and the openness of the economy close the wage gap to neighboring countries.

The pace of growth of investment activity will accelerate, prompted by fixed asset upgrades, an improved business climate and financial results, and a gradual resumption of bank lending.

Imported goods will satisfy most of the domestic demand, especially investment demand. This will bring the contribution of net exports to economic growth close to zero, despite Ukraine's growing export potential (driven by the diversification of Ukrainian exports and entry to new markets). Ukraine's economy will remain open, with a clear orientation towards trade in raw commodities. As a result, the Ukrainian economy will remain susceptible to global market volatility, which will primarily affect the current account deficit and then the FX market and inflation. An increase in labor mobility will pressure domestic demand and the FX market through inflows of money transfers and expectations of higher nominal wages, which may cause an additional negative impact on the current account.

The current account deficit is projected at around 4% of GDP in the coming years, a product of the greater need for imports of investment goods and technology, as well as large interest payments on external public debt. The NBU expects the Ukrainian economy to attract foreign direct investment (FDI). That would allow financial account inflows to exceed the size of the current account deficit.

The government is expected to plan budgets for the medium term and be prudent in its fiscal policy. The fiscal policy will be focused on gradually decreasing the fiscal deficit and the public debt-to-GDP ratio to meet the requirements of the Budget Code of Ukraine (no more than 60% of GDP). A prudent fiscal policy becomes even more important as major repayments of public debt draw nearer. The debt repayment requirements make the economy vulnerable if conditions for a return of the Ukrainian government to global capital markets were to worsen.

Inflation will be highly susceptible to food product supply factors since those goods account for a large share of the food basket and prices for those goods tend to be volatile. The expected growth in global demand for food products and increases in food exports are key determinants of food prices.

V. Specifics of Monetary Policy in 2018

The IMF and the OECD forecast global GDP growth of 3.6% in 2018. Scenario 1 of the Ukrainian government’s macroeconomic outlook sees Ukraine’s GDP growth accelerating to 3.0% in 2018 (Scenario 2: 4.0%, Scenario 3: 1.2%), while the NBU’s baseline forecast sees economic growth picking up to 3.2%.

Continued investment on the back of improved corporate earnings and a further increase of consumer demand fueled by the minimum wage increase will be key determinants of the GDP trend in 2018. Growth will primarily be driven by a gradual easing of fiscal and monetary policies, which will bolster consumer demand, as well as by the growth of exports on the back of improved terms of trade, high crop yields, and the resolution of raw material supply issues related to the suspension of cargo trade across the line of contact in Donetsk and Luhansk oblasts.

At the same time, imports will cover a significant part of domestic demand and capital investment. This will leave the contribution of net exports at close to zero over the forecast period.

The NBU's baseline forecast sees inflation continuing to decline on the back of prudent monetary and fiscal policies. The NBU's monetary policy is aimed at eliminating or mitigating inflation risks to meet the inflation targets of 6% (± 2 pp) as of the end of 2018 and 5% (± 1 pp) over the medium term.

For the quantitative inflation targets to be attained, the annual growth of the Consumer Price Index should meet the following quarterly markers:

March 2018: 7.5% ±2 pp

June 2018: 7% ±2 pp

September 2018: 6.5% ±2 pp.

Low inflation in Ukraine's main trading partners, moderate volatility of the nominal exchange rate, and a prudent fiscal policy based on a medium-term plan will help restrain prices from growing.

At the same time, in 2018 factors that will push prices up include the need to bring utility prices to breakeven levels, a hike in alcohol and tobacco excises to European levels, and the gradual pick-up of the global economy and the consequent growth in energy prices.

As inflation factors prevail, the NBU will need to maintain a moderately tight monetary policy to keep inflation within the target range. This will eliminate the second-round effects of the inflation factors, particularly their impact on inflation expectations and excessive growth in consumer demand. The key policy rate will remain above its neutral level for some time to help inflation come down to the announced target. However, the key rate will gradually get closer to neutral as inflation risks subside and inflation slows.

To promote financial stability, the NBU will continue:

Monitoring the stability of the entire financial system

Developing macroprudential policy i.e. detecting and assessing systemic risks to financial stability and taking preventive measures to minimize the risks. If necessary, the NBU will use monetary policy tools to neutralize shocks that impact Ukraine's financial system

Working to reduce related-party lending to a level that is safe for banks and the banking system

Initiating legislative changes aimed at further improving the functioning of Ukraine's financial system

The NBU will also identify ways of imposing additional economic requirements on banks to reduce the level of dollarization.

The NBU will continue to work closely with the government of Ukraine and other regulators to maintain financial stability, particularly within the framework of the Financial Stability Board's work.

To further reinforce the banking system's potential, satisfy the demand for credit that has resulted from economic growth, and provide money market players with more opportunities to hedge risks related to liquidity conditions, the NBU will consider holding variable rate tenders for refinancing with a maturity of up to five years and a fluctuating interest rate.

At the same time, the NBU's measures to promote real sector lending are not by themselves sufficient to ensure lasting economic growth. Ukraine's recent economic performance shows that – given an economic growth model based on low-added-value raw commodities exports – stimulating domestic demand has a short-term effect only. The country's economy remains vulnerable to changes in global commodity markets. To ensure stable economic growth and to improve living standards, Ukraine must solve important internal structural issues and lower the domestic economy's dependence on external factors. This requires a shift to an innovative economic development model and a shift in focus to achieving qualitative economic changes rather than quantitative growth objectives. It will require the coordinated work of all public bodies of various levels and the concentration of investment in industries that hold the most potential over the long run.

The most pressing structural problems in Ukraine’s economy bring about the need for the new economic model. In addition, the current financial and economic conditions favor the shift. The recovery of Ukraine’s economic growth amid a macroeconomic stabilization, the ample liquidity in the banking system, companies becoming profitable this year, and the state budget surplus increase the odds of the real and public sectors making an investment and economic breakthrough. This must become the priority of Ukraine’s macroeconomic policy as the state of the financial system and the stability of the domestic currency reflect the country’s economic progress.

VI. Risks to Monetary Policy Implementation

External Risks. Global raw commodity prices will be a major external risk for the economy. In case raw commodity prices decline, export income would drop. This, in turn, would pressure the current account and the hryvnia exchange rate. At the same time, the weaker competitiveness of domestic export-oriented enterprises and their diminishing effective demand would restrain economic activity. The major factor that would be capable of mitigating that risk to price stability and economic growth is largely beyond the reach of the NBU. That would be the implementation of structural reforms, which would transform the commodity-based nature of Ukraine’s economy. The NBU will use monetary policy instruments to mitigate the impact of shocks, which will help the economy return to equilibrium.

Internal Risks. Alongside the baseline forecast, in 2018 additional risks may materialize that could cause inflation to deviate from its projected path, which may prompt a monetary policy response.

The situation in the east of Ukraine is the main source of uncertainty. An escalation of hostilities would damage expectations and bring negative social and economic consequences.

The key political risk to macroeconomic stability lies in a slow implementation of the structural reforms envisaged by the joint program of Ukraine and the IMF, as well as a delay or cancellation of financing from international donors. The economic outcome of that scenario would worsen the closer we are to Ukraine’s major repayments of public and quasi-public debt in 2018-2019. The accumulation of reserves is viewed as a factor that can offset the negative impact the debt repayment will have on macroeconomic stability and business expectations.

Another risk to macroeconomic stability is the failure to adopt laws that would promote financial sector stability, build up the institutional capacity of financial market regulators, and protect the rights of financial services consumers and investors. The NBU will continue to support the adoption of these laws by the Verkhovna Rada of Ukraine.

The main uncertainty regarding inflation is related to an increase in administered tariffs, especially for energy resources, which could make inflation deviate from the projected trajectory.

In the fiscal sector, the most significant risk to prices is the possibility for increased government spending on social initiatives that are inconsistent with the inflation targets. That risk is especially relevant during the pre-election period of active campaigning. Another fiscal risk is related to possible changes in the government’s policy on household subsidies, which would impact real household incomes and aggregate demand in the economy. A greater emphasis by the government on financing current social expenditures may not only accelerate inflation, but also curb government investment and raise debt levels, which would affect mid-term economic growth prospects.

Risks related to food product supplies are also relevant for Ukraine: changes in weather conditions, changes to the animal disease situation, or the imposition of trade restrictions. These factors may have a major impact on crop yields and animal breeding output, as well as their exports.

The NBU will respond to shocks caused by the materialization of these risks largely by using the key policy rate based on the need to bring inflation up or down to the target levels.

Forecasts for monetary indicators and key macroeconomic indicators of economic and social development in Ukraine over the next year and the medium term

Indicators	2017		2018		2019		2020	
	Government* of Ukraine	NBU**	Government* of Ukraine	NBU	Government* of Ukraine	NBU	Government* of Ukraine	NBU
Inflation (Consumer Price Index):								
December to December, year-on-year change in percent	11.2	9.1	7.0	6.0	5.9	5.0	5.0	5.0
Average year-on-year change in percent	12.9	12.7	9.5	8.2	6.2	6.0	5.8	5.0
Inflation (Producer Price Index, December to December year-on-year change) in percent	16.8	12.7	7.0	9.8	7.2	8.2	6.0	6.0
Gross domestic product:								
nominal GDP, UAH billion	2846	2850	3248	3,220	3,611	3585	3981	3915
real GDP, year-on-year change in percent	1.8	1.6	3.0	3.2	3.6	4.0	4.0	4.0
Balance of trade, USD million	-6487	-5861	-7387	-6714	-7931	-5865	-7677	-5058
Exports of goods and services								
USD million	50735	51971	54419	54026	57718	57115	62427	60257
year-on-year change in percent	10.4	13.1	7.3	4.0	6.1	5.7	8.2	5.5
Imports of goods and services:								
USD million	57222	57832	61806	60741	65649	62980	70104	65315
year-on-year change in percent	10.6	11.7	8.0	5.0	6.2	3.7	6.8	3.7
International reserves, USD billion	-	20.0	-	27.1	-	25.7	-	25.9
Monetary base growth, percent	-	6.4	-	7.8	-	6.0	-	5.5
Money supply growth, percent	-	9.0	-	13.5	-	12.6	-	10.5
Profits of profitable enterprises, UAH billion	639	-	726.6	-	817.1	-	911.2	-
Payroll fund for salaried employees and remuneration of military personnel, UAH billion	796.3	-	972.3	-	1074.4	-	1185.9	-
Average monthly wages and salaries, gross:								
nominal, UAH	7104	6770	8629	7440	9540	8160	10537	8918
growth, adjusted by the Consumer Price Index, year-on-year change in percent	21.4	15.8	10.9	3.0	4.1	4.0	4.4	4.0
Economically active population aged 15-70 years, million individuals	16.25	-	16.35	-	16.42	-	16.55	-
Unemployment level among population aged 15-70 years according to ILO methodology, percent of the economically active population of a given age	9.3	9.3	9.1	8.6	8.9	8.0	8.5	7.8
Labor productivity growth, percent year-on-year	2.0	-	2.1	-	3.2	-	3.2	-

* Resolution No. 411 of the Cabinet of Ministers of Ukraine dated 31 May 2017.