National Bank of Ukraine

Summary of the Discussion on the Key Policy Rate at the NBU Monetary Policy Committee

Date of the meeting: **23 May 2018**

Attendees: nine out of ten members of the Monetary Policy Committee (MPC) of the National Bank of Ukraine:

Yakiv Smolii	Governor of the National Bank of Ukraine
Roman Borysenko	Deputy Governor
Kateryna Rozhkova	Deputy Governor
Dmytro Sologub	Deputy Governor
Oleg Churiy	Deputy Governor
Vitalii Vavryshchuk	Director of the Financial Stability Department
Sergiy Nikolaychuk	Director of the Monetary Policy and Economic Analysis Department
Yurii Polovniov	Director of the Statistics and Reporting Department
Serhii Ponomarenko	Director of the Open Market Operations Department

MPC members unanimously agreed that the key policy rate should remain unchanged, at 17.0% per annum.

The MPC members said that the actual inflation trend was mainly in line with the projections published in the April 2018 Inflation Report. The current monetary stance is tight enough to bring inflation back to its medium-term target over the forecast horizon.

When discussing the expected inflation path, the committee members mentioned two factors that have appeared since the latest macroeconomic forecast was made public.

First, a rise in global oil prices, which is rather rapidly feeding through to Ukrainian prices, due to the prices of fuel and lubricants making up a large share of the cost of products. This factor will create additional inflation pressures and be reflected in the inflation rate in the short-term.

At the same time, the committee members expect that the effect of the rise in global oil prices on price movements in Ukraine will be offset over a longer term. Higher oil prices will gradually push up global prices for other commodities, including Ukrainian exports. The resulting increase in foreign exchange earnings will affect the hryvnia exchange rate, and, consequently, decrease inflation pressures.

Second, the favorable weather conditions seen in the spring of the current year that offer hope of a good harvest of grain and early fruit vegetables. In particular, the Ministry of Agrarian Policy announced that winter crops were in the best condition since surveys started. As a result, the growth in food prices should decelerate rapidly.

The committee members also said that Ukraine’s economic growth indicators in Q1 2018 were higher than the NBU projected. If the baseline scenario materializes, real GDP growth projections may be revised upward to factor in expectations of a record harvest and increased consumption.

Special attention was paid to the synchronization of business cycles in Ukraine and the EU. Economic growth in these countries will increase export earnings and migrant remittances, which, in turn, will stimulate domestic demand in Ukraine.

When discussing the central bank's future monetary stance, the committee members said that there were two possible scenarios. Which scenario materializes will depend on whether or not progress is made with structural reforms, which are required for maintaining macroeconomic stability and receiving financing from the IMF.

The committee members said they believed that decisions important for continuing cooperation with Ukraine's official creditors would be taken in the near future. If the country steps up its efforts to carry out reforms, there is a good chance of receiving a USD 2 billion tranche and related financing this year, as outlined in the NBU's baseline macroeconomic scenario.

If the baseline scenario, which is based on continued cooperation with the IMF, materializes, the NBU should continue relaxing FX controls in order to promote economic growth.

At the same time, most committee members agreed that the probability that the key policy rate would be cut in the current year was low. The key policy rate can only be decreased when there are clear signs that inflation is steadily decreasing to its target value. The committee members also said that maintaining trust in the NBU's actions required conducting a consistent monetary policy, that aims to curb inflation, and avoiding fiscal dominance.

One committee member doubted the need to keep the key policy rate at 17% until the end of the year if things developed in line with the baseline scenario. He said that in such a case monetary policy would be too tight, as the benign effect of the exchange rate would depress inflation faster than currently assumed.

If structural reforms are delayed and no financing arrives from the country's official creditors, an alternative scenario will play itself out. The committee members agreed that failure to receive IMF tranches per se gave no grounds for raising the key policy rate. However, the Ukrainian economy remains heavily dependent on external financial and commodity market conditions. As a result, the absence of financial support from official creditors increases the vulnerability of the country's economy and financial market, especially when access to global capital markets is limited.

The committee members paid special attention to growing risks for developing economies, as exemplified by Argentina and Turkey. The experience of these countries clearly shows that conducting a consistent monetary policy is very important. It also shows that the loss of a central bank's independence and support for politically motivated decisions, such as financing budget deficits and keeping a low key policy rate, leads to external and internal imbalances by widening a current account deficit and increasing inflation.

This narrows developing countries' access to the global capital market. In this light, Ukraine should do all it can to carry out structural reforms and continue cooperation with official creditors.

The committee members agreed that if an alternative scenario materialized, policy decisions would depend on the assessment of all risks that could drive inflation up or prevent it from decreasing. If risks of inflation increase, the NBU may decide to raise the key policy rate again in order to bring inflation back to the target in the medium term. The key policy rate is the main monetary tool that is used to reduce inflation pressures. The NBU could also use FX market interventions to smooth out exchange rate fluctuations. The NBU will remain committed to the floating exchange rate regime by not counteracting main exchange rate trends.

When discussing additional measures that could be used in the case of an alternative scenario, the committee members considered the possibility of imposing FX restrictions. However, such restrictions are seen as a very unfavorable measure that could be applied as the last line of defense when there are serious threats to financial stability.

The Board of the National Bank of Ukraine decided to keep the key policy rate at 17.0% per annum at the meeting on monetary policy issues held on May 24, 2018.

For reference:

The Monetary Policy Committee (MPC) is the NBU's advisory body created for sharing information and opinions on monetary policy formation and implementation in order to deliver price stability. The MPC consists of the NBU Governor, other NBU Board members, and directors of the monetary policy and economic analysis, open market operations, financial stability, and statistics and reporting departments. The MPC meets one day before the NBU Board meeting on monetary policy issues. Decisions on the monetary policy issues are made by the NBU Board.