NATIONAL BANK OF UKRAINE

SUMMARY OF THE DISCUSSION ON **THE KEY POLICY RATE** AT THE NBU MONETARY POLICY COMMITTEE

Date of the meeting: **28 February 2018**

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

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

All those present agreed that in light of the need to bring inflation back to its mid-term target, **the NBU, following three previous increases, had to raise the key policy rate again, as expected in January's macroeconomic forecast.**

During the discussion, **most MPC members (six persons) said that the key policy rate had to be increased by 100 bp up to 17.0%.** The MPC members argued that since the last Board meeting on monetary policy issues no events had taken place that would help curb inflation faster than had been outlined in the current macroeconomic forecast (Inflation Report, January 2018).

The MPC members pointed out that the inflation risks the NBU considered when making its policy decision in January had persisted. These included:

- the high vulnerability of the Ukrainian economy resulting from delays in the disbursement of the next IMF tranche;
- the rising inflation expectations of economic agents;
- the solid growth in consumer demand.

Some MPC members argued that the inflation pressure was, to a large extent, the result of the continued rapid wage growth, including the increase in the minimum wage, and new initiatives to raise pensions further.

The MPC members also said that the key policy rate hikes that had occurred in recent months had contributed to foreign capital inflows, which had allowed reversing the depreciation trend in the hryvnia exchange rate.

The strengthening in the UAH/USD exchange rate that took place in February 2018 could have a positive influence on inflation expectations. However, the overall movements in the hryvnia exchange rate against the currencies of Ukraine's main trading partners were in line with the macroeconomic forecast and not yet conducive to a faster drop in inflation.

The MPC members paid special attention to the way the active foreign currency inflows seen from the start of the year could influence the economy. As foreign capital was mainly invested in short-term instruments, it might pose risks to the external sustainability of the economy. Following a discussion, the MPC members concluded that at present such risks were insignificant because capital inflows were small and investment was mainly made in government debt instruments in national currency. Nevertheless, the MPC members said that in order to prevent risks to the economy's external sustainability from increasing, the NBU had to oversee the situation on a continuous basis, and to coordinate its efforts with the Ministry of Finance. This could be done, among other things, by limiting the volumes of short-term domestic government bonds the Ministry of Finance sells on the primary market, while gradually increasing the volumes of long-term bonds.

The MPC members also discussed the transmission of earlier monetary decisions via the banking system. Some members stressed that the three previous policy rate hikes had discontinued the downward trend in interest rates on households' deposits. Meanwhile, the tighter monetary policy has not fully transmitted into higher household deposit rates yet. Short-term deposit rates are responding, as expected. However, banks are reluctant to revise their long-term deposit rates to avoid a decrease in their net interest income in the mid-term.

Two MPC members believed the key policy rate should be increased more gradually. One said that the rate should be raised by 50 bp in March and by 50 bp in April, while the other said it should be raised by 75 bp. They argued that monetary transmission occurred with a lag, and that there had not been enough time for bank rates to respond fully to the last rate increase that took place in January. The reforms required by the IMF could also speed up, which in turn could improve expectations and rein in inflation.

The MPC members said their vision of the next monetary policy decision was different from the one they had in January 2018. At the January meeting, most members stated that they could raise the policy rate again soon if there were no clear signs that inflation pressure was decreasing.

At the last meeting, however, **all members agreed that if the key policy rate was raised to 17%, there might be no need to increase it again in April.** The next monetary policy decision, which the MPC will discuss on 11 April and the Board will decide upon on 12 April, will depend on further developments, in particular on the inflation and whether or not there are clear signs that cooperation with the IMF will continue. However, if underlying inflation risks increase further, the NBU may raise the key policy rate again.

The Board of the National Bank of Ukraine decided to raise the key policy rate to 17.0% per annum at the meeting on monetary policy issues held on 1 March 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.