National Bank of Ukraine

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

Date of the meeting: **24 October 2018**

Attendees: ten 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
Kateryna Rozhkova	First Deputy Governor
Roman Borysenko	Deputy Governor
Dmytro Sologub	Deputy Governor
Serhii Kholod	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

During the discussion, **the opinions of MPC members were divided: five of them advocated maintaining the key policy rate at the current level (18.0%), while the other five favored its further increase to 18.5%.**

All MPC members agreed that as a result of continued significant fundamental pressure on prices and high inflation expectations, inflation decrease would be slower than expected. They also mentioned the persistence of inflation risks (more details are given in the Inflation Report).

At the same time, MPC members had different opinions on how the NBU's monetary policy should respond to such challenges.

Five MPC members noted that the current level of the key policy rate (18.0%) ensured sufficiently tight monetary conditions for further declining of inflation. They maintained that, despite the fact that inflation would enter the target range only in Q1 2020 given the current inflation factors and the unchanged key policy rate, this should not affect the trust in the NBU objectives, as the NBU had already demonstrated its readiness to pursue a tight monetary policy to achieve inflation targets. In addition, maintaining the key policy rate at the current level allows keeping the balance between the objectives of price stability and economic growth.

Among the arguments for keeping the key policy rate unchanged, the MPC members also came up with the following:

- The impact of the previous key policy rate hikes on the bank's interest rates has not fully materialized and will continue. Monetary conditions will become tighter as a result of a gradual decrease in the liquidity surplus of the banking system, accompanied by a rise in bank's interest rates on loans and deposits. In particular, stronger competition for resources among banks will lead to an increase in interest rates on retail deposits.

- Thanks to the progress made in cooperation with the International Monetary Fund, the risks to macrofinancial stability have weakened significantly. Along with that, the MPC members noted the importance for Ukraine to be in the IMF-supported program next year, taking into account the expected peak of public debt payments. This should have a positive effect on households' expectations and investors' perception of Ukraine. Since this risk was considered as a key one when making the previous decisions about the key policy rate, the supporters of the unchanged rate believed that it would be logical to abstain from raising the rate following the positive news about the new program of cooperation with the IMF.

At the same time, the mentioned five MPC members pointed out that, if inflation risks rise and threaten the inflation lowering to the target within a reasonable timeframe, the NBU would have the opportunity to respond at the next NBU Board meetings on monetary policy issues. Specifically, one MPC member noted that, in December, the decision on the key policy rate should take into account the possible increase in government spending at the end of the year and its impact on the financial market of Ukraine.

Other five MPC members concurred in the idea to raise the key policy rate by 50 bp up to 18.5%. These members of the MPC backed their opinion saying that a tighter monetary policy was required to alleviate the medium term effects on the inflation trend of such factors as worsening inflation expectations, stronger consumer demand, rapid wage growth, less favorable global financial conditions, and price environment.

Some MPC members stressed that real wage growth had been outpacing the growth in labor productivity. The growth in household income driven by higher wages, pension payments, and remittances fuels private consumption, leading to the persistence of underlying inflationary pressures. In order to offset the effect of this factor on prices, an additional impetus is needed to shift from consumption to saving.

As before, MPC members highlighted the difficult current financial conditions for developing countries and higher global energy prices as well as risks of further deterioration of the global environment. In particular, the focus was on the risk of a more rapid slowdown in the global economy, including the main trading partners of Ukraine, drop of world prices for raw commodities exported by Ukraine, possible further rise in global energy prices, risks of continued capital flight from developing economies, including Ukraine, due to fast switches to tight monetary policies by the central banks of leading countries.

In their opinion, increasing the key policy rate by 50 bp would be an appropriate response to the greater inflation factors. This decision will bring inflation to the target range by the end of 2019, as was expected, and eliminate risks of losing trust in the NBU inflation targets.

The MPC members have agreed that the NBU could raise the key policy rate to a level required to bring inflation back to its target over the mid-term horizon, **if inflation pressures do not ease or even build up.**

The Board of the National Bank of Ukraine decided to set the key policy rate at 18.0% per annum at the meeting on monetary policy issues held on 25 October 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.