National Bank of Ukraine

Summary of the Key Policy Rate Discussion by the NBU Monetary Policy Committee

Date of the meeting: **13 March 2019**

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

Kateryna Rozhkova	First Deputy Governor
Roman Borysenko	Deputy Governor
Sergii 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

As the discussion progressed, **six of the MPC members** advocated **maintaining the key policy rate at the current level (18.0%), while two members** suggested **lowering it: one member proposed to cut the rate by 0.5 pp (to 17.5%); the other argued for a 1 pp cut (to 17.0%).**

Inflation is decelerating in line with the forecast the NBU made in January, all of the MPC members pointed out. In February, inflation declined to 8.8%, while core inflation decreased to 7.8% in annual terms – evidence that the underlying inflationary pressure eased off. Furthermore, inflation expectations are improving across the board. This progress lays the groundwork for a transition to a monetary easing cycle, provided the reduction in inflationary pressure sufficiently persistent to bring inflation down to the target.

At the same time, risks to a further slowdown in inflation persist, as does the significant underlying inflationary pressure. In light of these facts, the MPC members found themselves divided on when best to launch the cycle of key policy rate cuts.

Lowering the key policy rate in March would be premature, most MPC members (six out of eight) pointed out, providing the following arguments to support their view:

- for inflationary pressure to continue to decrease from the still high level, a sufficiently tight monetary stance is necessary. At this time, the required tightness of monetary policy is best ensured by holding the key policy rate unchanged
- the NBU needs the public to have more confidence in its inflation targets. The main prerequisite for boosting confidence is to conduct a consistent monetary policy, which must remain tight in order to return inflation to declared targets
- ramping up social spending amid the political uncertainty that surrounds this year's presidential and parliamentary elections could worsen inflation expectations – something the NBU must factor into its key policy rate decision
- as the election cycle peaks, the banks may be less inclined to revise their interest rate policies,

biding their time to see how events play out. This will interfere with the effective operation of the monetary transmission mechanism and wipe out the impact of the key policy rate cut on market interest rates

- the recent easing of monetary policy by the ECB occurred as projections of economic activity and inflation in the euro area deteriorated significantly, triggering a rather negative response from financial markets and dampening investor interest in emerging markets. This may affect the conditions in Ukraine's FX market.

It would be too early to ease monetary policy now, but this option should be revisited in future meetings, six MPC members said after considering the arguments noted above. The launch of the cycle of key policy rate cuts should be timed in a manner that mitigates the risks that may prevent inflation from diminishing to the target.

Two MPC members voted to cut the key policy rate in March, substantiating their view as follows:

- actual and projected economic indicators suggest that a scenario that benefits Ukraine is materializing and that the underlying inflationary pressure is on the decline
- the uncertainty surrounding the political cycle will last for the most part of this year, and so the key policy rate decision should account for this factor only marginally
- the support Ukraine had received from its official creditors improved inflation expectations
- the decline in inflation will be supported by a prudent fiscal policy that will take into account sizable repayments on public debt
- favorable FX market conditions and the strengthening of the hryvnia will facilitate a further decline in inflation
- comments by the world's leading central banks signal a willingness to ease monetary policy by more than previously anticipated. This mitigates external risks to emerging markets and allows for easing the monetary stance without triggering a capital flight.

The weakening of inflation risks and the lower inflation enable the NBU to reduce the key policy rate as soon as April, the two MPC members opined.

One of the two MPC members argued that the key policy rate should be lowered by 0.5 pp. The NBU should demonstrate that an easing of monetary policy has been set in motion, as this will give a positive signal to the banks and the economy, the MPC member said in support of the proposed cut. At the same time, the size of the change in the key policy rate is not so important, the MPC member added.

The other MPC member recommended that the key policy rate be cut by 1.0 pp, to 17%. As a transition to the easing of monetary policy should have been started earlier, the key policy rate should be cut by a greater amount to sustain economic growth, the MPC member said.

The decision to keep the key policy rate at 18% per annum was approved by the NBU Board at the monetary policy meeting held on 14 March 2019.

For reference:

The Monetary Policy Committee (MPC) is the NBU's advisory body that was created to share information and opinions on monetary policy formulation and implementation in order to deliver price stability. The MPC comprises 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 the day before the NBU Board meeting on monetary policy issues. Decisions on monetary policy issues are made by the NBU Board.