Yakiv Smolii: National Bank of Ukraine press briefing - monetary policy statement

Speech by Mr Yakiv Smolii, Governor of the National Bank of Ukraine, at a press briefing on monetary policy, Kyiv, 25 April 2019.

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Dear colleagues,

Please be informed that the Board of the National Bank of Ukraine has decided to cut the key policy rate to 17.5% per annum.

Inflation has been on a steady decline towards the 5% target, allowing the NBU to launch a cycle of key policy rate cuts. At the same time, the NBU Board sees risks that may hinder the plans to lower the rate.

What inflation developments followed the last key policy rate decision?

In March 2019, consumer price inflation continued to slow and reached 8.6%, in line with the NBU's latest forecast. Core inflation declined even faster than expected – to 7.6%. This is evidence that underlying inflationary pressure continued to ease in early 2019.

The decline in inflation was supported by the NBU's tight monetary policy, which was one of the reasons for the strengthening of the hryvnia. That, in turn, impacted the prices of imported goods and goods with a significant import share in their production costs

Despite the electoral events, conditions in Ukraine's financial market remain benign, while inflation expectations of households, businesses, banks, and financial analysts continue to improve.

In addition to monetary factors, an increase in the domestic supply of some food products, and lower global food prices also dampened inflationary pressures.

What will be the future trajectory of inflation?

We expect that inflation will continue to decline gradually. More specifically, it will decrease to 6.3% by the end of 2019 and to 5.0% by the end of 2020. As projected before, inflation will enter the target range of 5% ± 1 pp in early 2020.

The slowdown in inflation was driven by the following factors:

- first and foremost, tight monetary conditions and restrained fiscal policy
- second, wage growth decelerated, as it approached the rates of wage growth of neighboring countries and labor migration from Ukraine declined in intensity
- third, the hryvnia appreciated in Q1 2019, holding down the future growth in prices for nonfood products
- fourth, global prices for natural gas declined, which will be reflected in price changes in the domestic market
- fifth, the supply of both domestic and imported food products increased.

These factors will also contribute to the continued slowdown of core inflation to 5.0% this year and 3.7% in the subsequent year.

The expected increase in some tariffs to the market levels and higher excise taxes on alcoholic and tobacco products will restrain the decline in inflation.

The NBU has also performed scheduled revisions of other macroeconomic forecasts

Economic growth will slow in 2019 to rebound in 2020.

As well as in January, the NBU forecasts a slowdown in economic growth to 2.5%.

This will be due to a slowdown in the global economy and trade, restrained fiscal policy resulting from the need to repay large volumes of public debt, and tight monetary conditions required to bring inflation to its target. Moreover, the harvest of grains and oil crops is expected to be lower compared to the bumper crop of 2018.

Private consumption will remain the main driver of economic growth. However, its growth will decelerate due to a slower growth in real household income – wages, pensions, and remittances from abroad. Investment demand will be limited by political uncertainty in the year of presidential and parliamentary elections.

Growth in real GDP will accelerate to 2.9% in 2020 and 3.7% in 2021. The growth will be propelled by a gradual easing of monetary policy, which will bolster domestic demand, and spur investment activity as the election cycle is over. Economic growth will be restrained by decreased volumes of natural gas transit to Europe as a result of the construction of bypass pipelines.

In 2019, the current account deficit is projected to stay at the previous year's level, at 3.3% of GDP, due to various factors. Proceeds from the sales of last year's record harvest of corn and the effect of favorable trade conditions will be offset, as the economies of Ukraine's main trading partners cool.

The cooling will negatively affect exports and remittances from labor migrants.

In future, the current account deficit will widen slightly, to 4% of GDP in 2021, as a result of a decrease in natural gas transit and weak demand from Ukraine's main trading partners caused by stronger investment demand on the domestic markets.

The continued fulfillment of Ukraine's obligations under the current cooperation program with the International Monetary Fund remains the basic assumption of the macroeconomic forecast.

This will allow Ukraine to attract other official financing, improve the conditions of access to the international capital markets, and support the active interest of nonresidents in hryvnia-denominated domestic government bonds. These borrowings will make it possible for the government to repay external public debt, the repayments of which will peak in 2019 – 2020. Inflows of debt capital and investments to the private sector will continue as well.

As a result, international reserves will hover around USD 21 to 22 billion during this and the subsequent years.

The usual increase in uncertainty during presidential and parliamentary elections poses the main internal risk to the said macroeconomic forecast, including Ukraine's ability to meet its inflation target in 2020.

The NBU will consider this risk in its monetary decisions mainly due to its impact on the financial market and inflation expectations.

The following external risks are also important:

- the global recession and lower raw commodity prices
- stronger geopolitical tensions, particularly due to the uncertainty around Brexit
- uncertainty over the volume of gas transit through Ukraine starting in 2020, as pipelines bypassing the country are being built to deliver gas to Europe
- an escalation of the military conflict and new trade restrictions introduced by Russia.

Taking into account the updated macroeconomic forecast and the said assessment of risks, the NBU Board decided to decrease the key policy rate to 17.5% per annum.

What will be the NBU's monetary policy stance in future?

As it initiates an easing cycle, the NBU Board points out that its further steps will depend on whether or not inflation risks materialize and whether or not inflation expectations improve.

However, despite there being macroeconomic preconditions for starting a cycle of key policy rate cuts, this process might be impeded by the materialization of risks to financial stability (that were mentioned in the statement of the Financial Stability Council last week), and to the central bank`s independence.

The NBU will closely monitor developments in Ukraine and, if the above risks materialize, will respond by deploying monetary tools.

A new detailed macroeconomic forecast will be published in the central bank's Inflation Report on 3 May 2019.

A summary of the discussion by Monetary Policy Committee members that preceded this decision will be published on 6 May 2019.

The next meeting of the NBU Board on monetary policy issues will be held on 6 June 2019.

I thank you for your attention!