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, 5 September 2019.

* * *

Dear colleagues,

The Board of the National Bank of Ukraine has decided to cut the key policy rate to 16.5% per annum, effective 6 September 2019.

The NBU is continuing the cycle of monetary policy easing, as it expects inflation to decline to the target of 5%.

What inflation developments followed the last monetary policy meeting?

Despite seasonal decrease of prices in July, inflation in annual terms was higher than our forecast and made 9.1% The NBUestimates inflation to have declined in August, although still remaining above the forecast level. The deviation was mostly driven by temporary factors related to food supply, in particular the supply of vegetables.

Meanwhile, core inflation was 7.4% was in line with the NBU's forecast. The tight monetary policy continued to hold back the underlying pressures on prices, in particular through the exchange rate channel. The appreciation of the hryvnia had the strongest impact on prices of fuel and some food products. However, disinflation was restrained by the greater consumer demand and the rise in real wages by almost 10% over the year.

What are the future inflation developments?

The NBU reiterates its forecast that inflation will meet the 5% medium-term target at the end of next year. Macroeconomic factors in place since the previous monetary policy meeting of the NBU Board have not changed the balance of risks to the forecast.

On the one hand, according to the NBU's estimates, a strengthening in the exchange rate will help curb inflation in the next few months.

The hryvnia appreciation was driven by fundamental market factors, such as:

- favorable global commodity prices
- good harvest of grain crops
- continued growth in IT services exports
- a stronger investor confidence in the Ukrainian economy
- the simplified access to the domestic government securities market for investors.

That reduced the amount of repatriated dividends and spurred demand for domestic government bonds. Although the impact of foreign capital inflows on the domestic government bond market weakened substantially over past weeks, the foreign exchange market has remained in balance.

The current drop in global oil and gas prices will be translated to domestic prices, with a certain time lag.

On the other hand, the rapidly rising domestic demand and strong wage growth will push prices upward. The more rapid GDP growth seen in Q2 2019 (to 4.6% yoy) was mainly driven by a pick-up in domestic consumption amid a faster improvement in consumer sentiment. The preliminary estimates of July economic activity showed that sustained domestic demand had persisted.

Internal political risks to reducing inflation to its target decreased after the new convocation parliament started to operate and a new government was formed. This makes it possible to intensify negotiations on a new cooperation program with the International Monetary Fund. At the same time, there are still threats to financial stability arising from current court proceedings related to the decisions taken by the state to improve the health of the banking sector.

External risks are also important. These include:

- a suspension of Russian gas transit through Ukraine starting in 2020
- increased trade tensions and more turbulent global financial markets
- an escalation of the military conflict and new trade restrictions introduced by Russia.

What is the NBU's current view of the future monetary policy stance?

The NBU will continue the cycle of monetary policy easing, provided inflation is steadily declining to its 5% target. How quickly the key policy rate is reduced to its neutral level of 8% will depend on both internal and external risks.

If structural reforms speed up, the NBU could cut the key policy rate more quickly. Another important condition is inflation decreasing steadily to its target.

Conversely, if inflation risks materialize, in particular through persistent demand pressure, the easing of monetary policy will be more gradual.

A summary of the discussion by Monetary Policy Committee members that preceded this decision will be published on 16 September 2019.

The next meeting of the NBU Board on monetary policy issues will be held on 24 October 2019.

Thank you for listening!