

Kyrylo Shevchenko: National Bank of Ukraine press briefing - monetary policy statement

Speech by Mr Kyrylo Shevchenko, Governor of the National Bank of Ukraine, at a press briefing on monetary policy, Kyiv, 15 April 2021.

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Dear colleagues,

I would like to inform you that the Board of the National Bank of Ukraine has decided to raise its key policy rate to 7.5% per annum. This step will help gradually slow down inflation in H2 2021 and return it to the 5% target already in H1 2022.

How did prices change in Q1 2021?

As expected, inflation deviated from the 5% \pm 1 pp target range, but the deviation was greater than forecasted. In particular, consumer inflation increased to 8.5% yoy in March.

On the one hand, the steeper rise in inflation was driven by temporary factors, such as:

- ♦ growth in global prices for some food products and energy
- ♦ global economic revival
- ♦ effects of last year's smaller harvests.

On the other hand, underlying inflationary pressures also increased. This was due to sustained growth in consumer demand, which was, among other things, fueled by higher wages. Moreover, inflation expectations remain high on the back of the rapid growth in the prices of goods consumed every day.

How will prices behave in the future?

The upward inflation trend will reverse in H2 2021. This will be due to several factors:

- ♦ new harvest supplies coming to the market
- ♦ the waned effect of low comparison base for some goods
- ♦ the effect of the increase in the NBU's key policy rate.

As a result, inflation will decline to 8% at the end of this year, return to the 5% target H1 2022, and subsequently remain there.

What will be the overall state of the Ukrainian economy?

The NBU estimates Ukraine's GDP declined somewhat in Q1 2021.

First, this was driven by the introduction of new quarantine restrictions, which dampened business activity. Second, last year's smaller harvests affected the performance of agriculture, the food industry, and freight turnover.

Third, increased competition in some global markets and greater trade restrictions imposed by Russia restrained the economic recovery. In addition, less favorable weather conditions in January–February weakened the performance of construction and transportation.

The Ukrainian economy will return to steady growth starting in Q2. Consumer demand will remain the main growth driver. Investment demand will also rise gradually as the global economy revives and more progress is made in overcoming the pandemic.

Factoring in losses to the economy caused by the tightening of quarantine restrictions, the NBU downgraded its GDP growth forecast for 2021 to 3.8%, down from 4.2%. The Ukrainian economy will grow at a pace of around 4% in 2022–2023.

The current account is expected to return to a slight deficit in 2021, propelled by higher domestic demand and the gradual revival of international tourism.

The current account deficit will widen noticeably in 2022 – 2023, propelled mainly by:

- ♦ less favorable terms of trade for exporters of agricultural and metallurgical products
- ♦ the expected drop in earnings from gas transit and
- ♦ continued growth in consumer and investment imports, fueled by the complete recovery of the global and Ukrainian economies from the coronavirus crisis.

Under what conditions would this forecast be realized?

The primary assumption of the NBU Board is that Ukraine will continue to cooperate with the IMF.

The NBU expects that Ukraine will make further progress in its talks with the IMF. Cooperation with the IMF and other international partners will enhance the government's ability to support the economy during the crisis, while also helping Ukraine pass through the period of debt repayments that will peak in the coming autumn.

This cooperation will help maintain Ukraine's international reserves at a reasonably high level of USD 29 to 30 billion in 2021 – 2023.

The key risk to the macroeconomic forecast is the imposition of stricter quarantine measures in Ukraine and globally, and the slow pace of the vaccination campaign domestically.

New waves of the pandemic forced countries to once again tighten quarantine restrictions in Q1 2021. Despite the partial adaptation of businesses to the new conditions, this is slowing the recovery of business activity.

The slow pace of the vaccination campaign in Ukraine, coupled with higher inflationary pressures arising from the rebounding global economy, poses an additional risk of future economic losses.

There are other significant risks. They include:

- ♦ an escalation of the military conflict in eastern Ukraine or on the country's borders
- ♦ volatile global capital markets and
- ♦ a dramatic deterioration in the terms of trade.

Taking into account all of the above, the NBU Board decided to raise the key policy rate to 7.5%.

How does the NBU intend to change the key policy rate in future?

The NBU's forecast envisages that the key policy rate will remain unchanged, at 7.5%, until the end of 2021. Given current inflationary movements, this should suffice to bring inflation back to its 5% target in H1 2022.

However, if underlying inflationary pressures rise more noticeably than currently expected, and if inflation expectations worsen, there could be the need for further monetary policy tightening.

The NBU stands ready to continue raising its key policy rate to a level that will bring inflation back to its 5% target in H1 2022.

Thank you for your attention!