

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, 21 October 2021.

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Dear colleagues,

I would like to inform you that the NBU Board has decided to raise the key policy rate to 8.5% per annum.

This decision comes in line with a decline in inflation to 5% at the end of next year projected in the baseline scenario of the updated macroeconomic forecast.

What price developments followed the last monetary policy meeting of the NBU Board?

As expected, consumer inflation ranged between 10% and 11% in the past several months, which was close to the forecast the NBU made in July. Underlying inflationary pressures also expectedly persisted, and inflation expectations remained high.

At the same time, benign FX market conditions restrained price growth, keeping core inflation below the July forecast trajectory.

How will prices behave going forward?

The NBU expects the growth in consumer prices will peak in September–October this year. Afterwards, the inflation trend will reverse, and inflation will slow to 9.6% at the end of the year. The NBU expects inflation to decline to the 5% target at the end of 2022 and remain close to this level further on.

Inflation will slow thanks to waning low base effects, FX markets remaining favorable, and this year's large harvests. The monetary policy tightening actions taken earlier by the NBU, in particular the optimization of the monetary policy design, a complete phaseout of anti-crisis monetary measures, and raising the key policy rate, will also curb growth in consumer prices.

At the same time, a faster disinflation will be restrained by energy prices remaining high longer and by sustained consumer demand. Considering the lasting effects of these pro-inflationary factors, the NBU will have to tighten the monetary conditions in 2022–2023 more than was expected in July in order to bring inflation to the target of 5%.

What will be the overall state of the Ukrainian economy?

The economy has been actively recovering in H2 2021. This is evidenced by high-frequency indicators of economic activity. In particular, a record harvest of early grain crops spurred growth in agriculture. Robust consumer demand supported retail trading and passenger turnovers. A pickup in investment activity, together with a favorable external price environment, contributed to a recovery in construction and industrial production.

At the same time, the impact of the pandemic turned out more persistent and strong. Coupled with the consequences of the surge in natural gas prices, this led to a weaker performance of the Ukrainian economy in H1. Therefore, the NBU has downgraded its economic growth forecast for 2021, from 3.8% to 3.1%.

Unfavorable conditions on the energy market and the impact of global logistic problems will limit Ukraine's industrial output, thus curbing economic recovery next year. To this end, the NBU has

revised downward its GDP growth forecast for 2022, from 4% to 3.8%. GDP is expected to grow by 4% in 2023.

Over the forecast horizon, economic growth in Ukraine will be driven by:

- ♦ continued global economic recovery
- ♦ an increase in domestic demand, including investment demand
- ♦ the terms of trade remaining favorable for Ukrainian exporters
- ♦ the progress in vaccinations, which will prevent the imposition of lockdowns or other restrictions on economic activity.

In 2021, the current account deficit will hit about 1% of GDP on the back of a bumper harvest and high export prices. In the coming years, the deficit will gradually widen to 3% to 4% of GDP. The deficit will be driven by some worsening in the terms of trade and more robust consumer and investment demand resulting from economic recovery.

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.

Ukraine reached staff level agreement with the IMF. This has opened the way for the first revision of the Stand-by Arrangement (SBA) by the IMF Executive Board, and for consideration of the request for the program to be continued.

The implementation of the existing Stand-by Arrangement will ensure the receipt of required official financing in 2021–2022, provide better terms of external borrowing, while also supporting foreign investors' interest in hryvnia assets.

Cooperation with the IMF will help speed up economic growth, stabilize inflation at its target level, and maintain international reserves at USD 30 to USD 31 billion in the coming years.

The key risks to the economy are the imposition of stricter quarantine measures in Ukraine and globally, and a longer and more pronounced than expected surge in global inflation. Higher morbidity due to the low vaccination coverage in Ukraine could lead to a stricter lockdown and, consequently, a more significant slowdown in economic activity. However, in contrast to the quarantine imposed last year, this time supply will be more affected than demand, which could increase pro-inflationary pressures.

What is more, a more protracted global price surge than currently expected will put pressure on domestic prices.

Other pro-inflationary risks also remain important. They include:

- ♦ a sharp deterioration in terms of trade, capital outflows from emerging markets and
- ♦ an escalation of the military conflict with Russia.

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

As set forth in the baseline scenario, with a view to bringing inflation back to its 5% target, the NBU will keep its key policy rate no lower than 8.5 % at least until Q3 2022 rather than until Q2, as was expected in July.

The key policy rate will be cut more gradually in 2022 than forecast before. The key policy rate is also expected to stand at 7.5% in late 2022, as opposed to 6.5%, as predicted in the previous forecast.

If the said or any other pro-inflationary risks materialize, the NBU stands ready to raise its key policy rate and deploy other monetary tools. It could decide to do so even during the December meeting.

Thank you for your attention!