Andriy Pyshnyy: National Bank of Ukraine press briefing - monetary policy decisions

Speech by Mr Andriy Pyshnyy, Governor of the National Bank of Ukraine, at a press briefing on monetary policy decisions, Kyiv, 26 January 2023.

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Dear colleagues,

The Board of the National Bank of Ukraine has decided to keep the key policy rate unchanged at 25% per annum and to continue raising required reserve ratios for banks.

This will facilitate a further increase in the attractiveness of hryvnia assets, support exchange rate stability, and gradually slow inflation.

Inflation has stabilized in the past months but is still high

As of the end of 2022, consumer prices grew by 26.6%. At the same time, in the past three months, inflation remained almost unchanged in annual terms. The de-occupation of territories, an increase in supply of food products, and consumer demand being dampened by the energy sector destructions helped stabilize the inflationary pressure.

Inflation was also restrained by unchanged utility tariffs, the fixed exchange rate of the hryvnia, and improved logistics. The NBU's measures, in particular to introduce deposit instruments to hedge the FX risk, as well as limited volumes of monetary financing of the budget, contributed to a more stable FX market at the end of 2022.

At the same time, the price pressure remained strong due to consequences of the invasion, such as the destruction of enterprises and infrastructure and disruption of production and supply chains. Moreover, business costs continued to grow on the back of the energy sector destructions. Despite a stabilization, inflation expectations remained high.

Inflation will decline gradually and will remain under control thanks to measures taken by the NBU and the government and the support provided by international partners

The NBU forecasts inflation will slow to 18.7% in 2023, supported by monetary conditions remaining tight, global inflation declining, and consumer demand being dampened by power outages. Inflows of announced international assistance and joint efforts of the NBU and the government to revive the domestic debt market will help avoid monetary financing of the budget deficit and balance the FX market.

In the next years, inflation will decelerate more rapidly thanks to subsiding security risks, proper recovery of logistics, and larger harvests.

The economic recovery ceased due to military attacks against energy infrastructure. As security risks subside, Ukraine will return to steady economic growth in 2024–2025

The critical infrastructure destructions deepened the decline in Ukraine's GDP in Q4 2022 (to 35% yoy). Trading businesses and the services sector adapted to power outages rather quickly. This, coupled with stronger performance in Q3, led to an upward revision of estimated decline in real GDP in 2022 to 30.3%.

The NBU expects growth in real GDP to be weak in 2023, at 0.3%. The deterioration of the forecast compared to the October estimates was primarily caused by consequences of the energy sector destructions and the revision of the main assumption of the duration of security risks. The forecast assumes in 2023 Ukraine will manage to avoid further significant destruction of its energy infrastructure, while businesses and authorities will take effective measures to neutralize the consequences of the damage inflicted earlier.

The economy will grow in 2024–2025, driven by a decline in security risks, along with a resumption of proper operation of ports, an increase in harvests, a gradual recovery in production, an improvement in logistics, and a pick up in domestic demand, including thanks to the return of displaced persons. The loose fiscal policy will also play an important role. All of the above will push up Ukraine's real GDP by 4.1% in 2024, and in 2025 economic growth will accelerate to 6.4%.

International aid, coupled with cooperation with the IMF, will finance Ukraine's substantial budget deficit, and maintain international reserves at a sufficient level.

In 2022, Ukraine received over USD 32 billion in international assistance, of which over USD 14 billion was in the form of grants. This enabled the country to finance a larger portion of the consolidated budget deficit, and to increase international reserves, to USD 28.5 billion by the end of the year. Currently, reserves are sufficient to safeguard the stability of the FX market.

In view of the already announced international aid and progress made in negotiations with the IMF, overall official financing in 2023 could exceed USD 38 billion. This will enable Ukraine to refrain from the monetary financing of the budget deficit in 2023, and to maintain international reserves at a sufficient level even in the face of longer-lasting high security risks. International reserves are expected to hit about USD 27 billion by the end of 2023, and will continue to rise.

The key assumption of the forecast is that security risks will start to decline significantly from early 2024. A prolonged war and further destruction of critical infrastructure remain the key risks.

The NBU has revised its key assumption of the security situation forecast due to fiercer fighting and escalating military attacks on the country's critical infrastructure. The baseline scenario of the new macroeconomic forecast envisages a noticeable decrease in security risks from the start of 2024. Therefore, the full unblocking of seaports and reductions in Ukraine's risk premiums have been delayed in the NBU's forecast. More intense hostilities and greater power shortages than expected due to air attacks could dampen economic activity more significantly, while also increasing inflationary pressures.

Other risks also have a bearing on the forecast. If materialized, they could also require revisions in key macroeconomic indicators.

That said the rapid implementation of the recovery plan for Ukraine, supported by the arrival of official and private financing, could markedly speed up economic growth.

In order to bring inflation back to the steady decline trajectory and to maintain exchange rate and macro financial stability amid high uncertainty, the NBU Board decided to keep the key policy rate at 25%.

At the same time, the NBU has raised reserve requirements for banks, as it said it would do in December. More specifically, from 11 February the banks' required reserve ratios will be raised by 5 pp for demand deposits from, and current accounts of, businesses and households; for deposits from, and current accounts of, nonresident banks; and for loans from international (other than financial) and other organizations. In particular, from 5% to 10% for hryvnia funds and from 15% to 20% for FX funds.

What is more, from 11 March the banks' required reserve ratios will be raised by another 10 pp for household hryvnia and FX demand deposits and current accounts. The banks will not be allowed to use benchmark domestic government debt securities to meet these reserve requirements.

The NBU expects that these measures will help decrease the liquidity surplus in the banking system. This, in turn, will encourage the banks to compete more actively for time deposits, which will push up interest rates on hryvnia assets and increase the share of time deposits.

This will make the FX market more resilient to situational factors, while also enabling the NBU to ease administrative restrictions for businesses and households in future.

The revised forecast envisages keeping the key policy rate at 25% at least until the end of Q1 2024. If required, the NBU stands ready to deploy other tools to avoid the monetary financing of the budget deficit, make hryvnia assets more attractive, increase the resilience of the FX market, and lay the foundations for easing administrative restrictions.

Thank you for your attention!