Andriy Pyshnyy: Navigating the changing landscape - central banks in a new normal

Speech by Mr Andriy Pyshnyy, Governor of the National Bank of Ukraine, at the 8th Annual Research Conference "Navigating the changing landscape - central banks in a new normal", organized by the National Bank of Ukraine and the National Bank of Poland, Kyiv, 21 June 2024.

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Dear guests, colleagues, and viewers of the broadcast!

My greetings to all participants of the 8th Annual Research Conference of the central banks of Ukraine and Poland.

I am very glad this professional discussion has returned to Kyiv. This is symbolic. At the same time, it adds appropriate context to the discussion. After all, the topic we have been discussing over the conference's two days concerns a very important issue – Navigating the Changing Landscape: Central Banks in a New Normal**.**

It is remarkable that not a single speaker has questioned the very fact that this new normal exists. Nor has anyone cast into doubt that this landscape has indeed become a fast-changing environment.

The theme that permeates all debates today in one way or another is the challenges and tasks posed by the new reality that emerged on 24 February 2022. And central banks are no exception.

In February 2022, the National Bank of Ukraine faced central bankers' greatest fears, which materialized simultaneously: the country lost a third of its GDP, 20% of the territory was occupied, migration reached staggering numbers of more than 16 million people. The war was generating an ever-increasing budget deficit every minute. The NBU had to resort to monetary financing of budget to support the country's defense capabilities. Inflation was growing rapidly.

We found ourselves in the eye of a perfect storm – as powerful as it was unpredictable. No central bank probably had ever experienced such a concentration of shocks. We had to respond instantly: by implementing emergency protocols, by looking for optimal solutions in the shortest possible timeframe, by using unorthodox and innovative tools... **If I were to put it into one term, I would call it "extreme uncertainty."**

Uncertainty that fundamentally changed Ukraine's and the world's reality.

Uncertainty that has already become a new normal for us.

The paradox of this situation is that the upsurge in uncertainty triggered elevated expectations for the projections and decisions generated by the central bank. We have been seeing this for the third straight year, and now it is even more tangible:

people want our work and decisions to be an island of stability in the middle of a storm that keeps raging.

Our observations have been confirmed by Banque de France's Governor François Villeroy de Galhau, who said, "***The credibility of central banks and their resolute course of action have a consequence: they are fueling growing public expectations***."

There is a direct relationship: the more effective the policy that a central bank pursues and the higher its credibility, the more people expect from the central bank's decisions.

This is what unites us with other central banks. They also deal with expectations.

Central banks in different countries may have differently worded their statutory mandates, but each central bank directs its efforts toward shaping and managing expectations and maintaining trust, which is a key aspect of ensuring the effectiveness of central bank policy.

We have some insights that I will share, but we certainly do not have all the answers.

So, today we will look for answers together, and the **first question is:**

How to maintain a central bank's credibility amid high uncertainty while undergoing a dramatic transformation?

Despite the tremendous experience the NBU has gained, as the war wears on, uncertainty is constantly generating new challenges. Challenges for us. Challenges for the whole world.

The echoes of the storm that started in Ukraine can be felt now both on the European continent and across the ocean.

The war has already affected global food security, migration flows, and redistribution of budgets in favor of military spending. The war is affecting logistical and production capabilities, encouraging tighter border control on land and water and in cyberspace. The war is being reflected by slowing rates of economic growth and rising global inflationary pressures.

The world is highly interconnected through trade, financial, and geopolitical networks. As a result, we are seeing that big shocks can have avery different asymmetric and non-linear effects due to complex interrelated economies and rapidly worsening expectations.

And under the laws of perfect storm, the worst-case scenario can happen...

Hence question two: Are central banks ready to face the challenges of war if it comes close to their countries' borders?

The NBU's experience proves that conventional approaches and tools are no longer enough to effectively implement the central bank mandate. And in some cases, new challenges dictate the need to change not only the approaches, but the very philosophy of central banking.

Since the war's onset, we have accumulated a unique base of knowledge and solutions that has proved effective amid high uncertainty. Over this time, the financial sector and the economy have gone from survival and adjustment stages to gradual recovery.

Along with solutions, we have also developed several insights that I expect you and I will augment during the panels today.

1. Central banks should prepare for crises. In emergencies, we do not rise to the level of our expectations, we fall to the level of our preparedness.

The idea of crisis preparedness is nothing new. It lies at the core of ensuring financial stability, which became a widespread part of central banks' mandates after the Asian market crisis and was cemented as such by the 2007–2008 global financial crisis.

In essence, crisis preparedness involves creating a system of buffers and an early warning system that operate on the principle "prepare today for what may come tomorrow." Central banks should not be afraid to take into account the relevant experience from different cases.

The NBU started preparing immediately after Russia annexed Crimea in 2014. Thanks to prearranged action protocols and a package of anti-crisis measures put into effect on 24 February 2022, we were able to stabilize the situation.

We managed to prevent panic, stem capital outflows, and help the country fight and defend its independence.

We pegged the exchange rate to the U.S. dollar and imposed administrative restrictions on FX transactions and cross-border movement of capital. We activated the banking system's business continuity protocols.

Have you ever heard of any countries where people could easily use payment cards amid a full-scale war, even on its first day?

I know of only one such country. Ukraine.

Not a single payment was denied, not a single Ukrainian bank stopped operating. People had uninterrupted access to their money and continued to keep their deposits in banks. We supported the country's budget by issuing UAH 400 billion in monetary financing as Ukraine waited for financial support from partners. We did it because the defense forces needed immediate funding.

A tactical medicine phrase I often use to explain the essence and importance of crisis response is very apt. In the event of severe injury (which is how you can describe the invasion's impact on the Ukrainian economy), compress the damaged blood vessels with a tourniquet to stop the bleeding as soon as possible. Our emergency measures became such a tourniquet for the financial system. Over time, however, the tourniquet itself starts posing a threat and must be loosened up and then removed in order for the body to begin to recover. Our second insight is about how to do this safely in the face of a war:

2. In times of uncertainty, strategic planning helps you stay on course.

The war raged on with no quick ending in sight, and so the economy, businesses, and people had to adjust to operating under martial law.

This required us to calibrate our toolkit. In effect, we had to invent monetary policy under wartime conditions. We had to find a new normal.

So, how were we to proceed?

Strategic planning became our solution. It helped us identify the right signposts and answers.

Despite wartime uncertainty, we updated two key strategic documents: the NBU Strategy and the Strategy of Ukrainian Financial Sector Development. And then, jointly with IMF experts, we developed the Strategy for Easing FX Restrictions, Transitioning to Greater Flexibility of the Exchange Rate, and Returning to Inflation Targeting.

The NBU strategy came to be called Financial Fortress, a name that refers to a certain level of strength and stability expected of us by stakeholders, financial sector participants, businesses, and households, meaning the end users of financial services or virtually everyone.

Gradually, by making step-by-step headway towards our strategic goals, we were able to achieve a point where the economy began to recover despite the war, and where the financial sector continued to undergo reform, because we could not afford put off our European integration efforts until after the war ended.

3. Not only is the new reality forcing central banks to transform, but also it is motivating other institutions – governments and IFIs – to do so.

In 2023, the IMF approved an EFF program for Ukraine that I really consider historic. Not only because we managed to secure an unprecedented amount of financial assistance from partners.

And not only because, under the program, Ukraine is implementing an ambitious reform plan that strengthens its stability and capacity.

The program was evidence of the IMF's new perspective on reality. It set a precedent in which the IMF reconsidered its own lending policies and opened up to the possibility of working with countries that face extremely high uncertainty generated by exogenous factors. The IMF showed maturity and leadership in responding to the challenges posed by the new reality.

Another example of such a transformation is the reset of the relationship between the NBU and Ukraine's Ministry of Finance based on a clear understanding of the limits of each other's mandate, and at the same time on awareness of our common goal.

In one of her interviews, Christine Lagarde emphasized the growing role of coordinated actions by monetary and fiscal authorities amid high turbulence. ***"Monetary and fiscal policy play a complementary role in fighting price pressures. They must work hand in hand and not contradict each other,"*** she said.

This is hard to deny.

Such cooperation somehow expands the NBU's mandate, engaging the central bank to resolve the problem of closing the fiscal gap, a task that is usually beyond the scope of the central banks' attention. Ms Gita Gopinath also mentioned this at our meeting yesterday. But the emergency situation – the new reality – requires that we take novel approaches.

It was thanks to the new quality of interaction with the fiscal authorities that we were able to revive the domestic debt market, making it possible to raise more than UAH 1 trillion in domestic financing amid a full-scale war. What is more, the NBU's participation in the clampdown on shadow schemes that used to cause the billions of hryvnias losses of the state budget has made this fight increasingly more effective. Today, these funds are going towards the budget and fueling our ability and capacity to resist.

And most important, such synergy makes it possible to find nonmonetary channels for boosting revenues to the budget. Even as the war grinds on, we have not resorted to central bank financing of the budget deficit since the beginning of 2023.

4. As central bankers, it is vital for us to learn to take a broader look, to search for new ways of pursuing our mandate in order to maintain macrofinancial stability in the new reality.

The NBU took this approach by participating in the implementation of the government's sanctions policy against Russia. The tightening of sanctions, the monitoring of sanctions compliance, the continual tracing down and detection of sanctions evasion schemes, the isolation of Russia's financial system – all of these efforts are gradually draining the resources that Russia is using to bankroll its war.

5. Uncertainty generates global risks to central banks' independence.

Kristalina Georgieva, Managing Director of the IMF, also talks about them in her program article: ***Strengthen Central Bank Independence to Protect the World Economy***. I would like us all to remember that central bank independence is both a goal and a huge resource for countries. The results of the IMF study cited by Ms Georgieva confirm that ***independence is critical to winning the fight against inflation and achieving stable long-term economic growth.***

Independence is the basis for trust in a central bank's actions. The value of such credibility in unstable times is extraordinary. And so we must keep this challenge in mind today.

Last but not least, I will mention a phrase that has been enshrined in the NBU's mission since 2023. It is a very simple and clear message: we remain committed to our goals of ensuring price and financial stability. **And we take responsibility to achieve these goals under any circumstances.**

This sentence covers all of the talking points laid out above and leads us to the **third, key question:**

How should a central bank transform itself to remain sustainable and effective in the new normal? What should be changed, and what should stay the same?

We have three panels and a keynote speech by Ms Gita Gopinath ahead of us, and these questions will be raised without a doubt. This discussion is crucial for us. We are open to searching answers together. It is important that we "write this textbook" on the operation of central banks in wartime, and that we write it together under conditions of extreme uncertainty.

I look forward to watching the panels and gaining new insights.

Let's have a fruitful day of discussions.