National Bank of Ukraine

Summary of the Key Policy Rate Discussion by the NBU Monetary Policy Committee

Date of the meeting: **12 December 2018**

Attendees: ten out of ten members of the Monetary Policy Committee (MPC) of the National Bank of Ukraine:

Yakiv Smolii	Governor of the National Bank of Ukraine
Kateryna Rozhkova	First Deputy Governor
Roman Borysenko	Deputy Governor
Dmytro Sologub	Deputy Governor
Serhii Kholod	Deputy Governor
Oleg Churiy	Deputy Governor
Vitalii Vavryshchuk	Director of the Financial Stability Department
Sergiy Nikolaychuk	Director of the Monetary Policy and Economic Analysis Department
Yurii Polovniov	Director of the Statistics and Reporting Department
Serhii Ponomarenko	Director of the Open Market Operations Department

During the discussion, **nine of the MPC members advocated maintaining the key policy rate at the current level (18.0%), while one member suggested lowering it 0.5 pp, to 17.5%.**

In the course of the discussion, the MPC members expressed a unanimous view that as a result of a number of positive developments, pro-inflation risks have declined in intensity since the MPC last met in October.

Among the factors that helped mitigate the risks, the MPC members emphasized the following:

- The record-high harvest of corn and sunflower, which will make these crops and related products (sunflower oil, feed, etc.) cheaper.
- The more significant decrease in global energy prices than the NBU assumed when it made its last forecast. The positive effect of this factor will gradually transmit itself to domestic prices.
- The tight fiscal policy, which helps ease pressure from consumer demand.
- The improvement in external conditions for emerging markets, which was driven by the lower likelihood of trade conflicts growing to full-scale proportions and by expectations of a less sharp interest rate hike by the Fed next year.
- Favorable FX market conditions, characterized by appreciation pressure on the hryvnia in view of the above-listed factors.

The MPC members acknowledged the fulfillment of the key assumption underlying the NBU's October macroeconomic forecast: the significant progress in continuing the cooperation between Ukraine and the IMF under the new Stand-By Arrangement, as well as the disbursement of related financing from other official lenders.

In addition, there is evidence that inflation expectations have improved and bank deposit rates have increased as a result of earlier hikes in the key policy rate – another assumption in the October macroeconomic forecast.

As pro-inflation risks have diminished, the decision to keep the key policy rate unchanged is in line with the monetary policy vision the NBU declared in October, when it made its previous decision on key policy rate, most MPC members (nine of them) emphasized. The vision consists in the idea that if inflationary pressure persists or builds up, the NBU may chose to raise the key policy rate.

At the same time, the nine MPC members shared the view that inflationary pressure and risks, though eased, remained significant. This creates the need to maintain the tight monetary policy stance. The NBU has to be ready to raise the key policy rate further, should inflationary pressure increase.

To support their position, these MPC members cited the following risks:

- A deterioration of expectations as the new political cycle unfolds.
- Materialization of geopolitical risks, such as an escalation of the Sea of Azov conflict, potentially reducing export revenues.
- Further pressure on prices from robust consumer demand, including as a result of higher wages.
- A cooling-off of the global economy.

These MPC members (nine of them) also mentioned that a key rate cut in the future is possible no earlier than risks to bringing inflation to the target on the forecast horizon substantially diminish.

By contrast, **one MPC member** argued that the key policy rate should be cut 0.5 pp, to 17.5%. The lower inflation risks allow the NBU to ease its monetary policy, the MPC member said. The factors that, going forward, may put upward pressure on inflation are mainly beyond the scope monetary policy, the MPC member said in further substantiating the argument for a rate cut. High interest rates put more appreciation pressure on the hryvnia and thus adversely affect the current account of the balance of payments, the MPC member argued.

The decision to set the key policy rate at 18.0% per annum was approved by the NBU Board at the meeting on monetary policy issues held on 13 December 2018.

For reference:

The Monetary Policy Committee (MPC) is the NBU's advisory body created for sharing information and opinions on monetary policy formation and implementation in order to deliver price stability. The MPC consists of the NBU Governor, other NBU Board members, and directors of the monetary policy and economic analysis, open market operations, financial stability, and statistics and reporting departments. The MPC meets one day before the NBU Board meeting on monetary policy issues. Decisions on the monetary policy issues are made by the NBU Board.