Monetary policy reaction: consistency and predictability in highly uncertain environment

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No privilege to hesitate for young IT central bank. The NBU was among the first CB`s to hike the key rate

### Movements in key policy rates in EM countries in 2021

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Source: official web-pages of central banks, as of 19.11.21.

### Years of introduction of inflation targeting

Source: official web-pages of central banks, IMF.
Little reason to rely on transitiveness of inflationary shock if there is a risk of un-anchoring expectations

12-month-ahead inflation expectations*, %

* The dotted line indicates a change in the method of survey for a telephone interview due to quarantine restrictions.
Source: NBU, GfK Ukraine, Info Sapiens.
High credibility makes it less costly for a central bank to stabilize inflation

Source: Savolchuk and Grui (forthcoming).
Credibility to the CB and to national currency needs to be preserved

The primary market yields on hryvnia domestic government debt securities, %

Source: NBU.
Not considering inflation as a self-resuming problem revealed to be the right strategy

Most Cited Potential Shocks over Next 12 to 18 months*

- Persistent inflation; monetary tightening
- Vaccine-resistant variants
- China regulatory/property risks
- U.S.-China tensions
- Cryptocurrencies/stablecoins
- Climate/weather
- Risk-asset valuations/correction
- Political uncertainty
- Fiscal cliff effects
- Cyberattacks
- Real yield spike/taper tantrum
- EME risks
- China slowdown

Balance of CBs’ sentiments according to press releases on monetary policy decisions*, % of CB

* Federal reserve Bank of New York survey of 26 market contacts from August to October

There is the need to move in right direction while avoiding to shock the market with own actions

Key rate, %

Monetary policy tightening in line with forward guidance, but higher than previously projected.
A more decisive step was aimed to reduce higher than expected fundamental inflationary pressure and stabilize inflation expectations

Monetary policy tightening in line with forward guidance, but higher than previously projected.
Given the significant rise in fundamental inflationary pressures, it was necessary to raise key rate in order to reduce inflation expectations and bring inflation back to the target in 2022

Monetary policy tightening in line with forward guidance and the forecast (IR July 2021), maintaining the one-sided forward guidance on readiness for further key rate hikes

Keeping key rate unchanged, but hawkish forward guidance

Monetary policy tightening in line with forward guidance and the forecast (IR Jan 2021)

Keeping key rate unchanged in line with forward guidance and the forecast (IR Apr 2021), but strengthening the one-sided forward guidance on readiness to take additional measures if pro-inflationary risks materialize

Keeping key rate unchanged in line with forward guidance and the forecast (IR Apr 2021), but keeping key rate unchanged in line with forward guidance and the forecast (IR Jul 2021)
The NBU has phased-out emergency monetary measures in a predictable way

- **June, 17 2021** – the NBU announced about gradual phase-out of anti-crisis monetary measures (long-term refinancing and interest rate swaps)
- Monetary policy normalization is in line with the *Monetary Policy Guidelines for 2021*

Gradual phasing out of emergency measures ➡️ in order to minimize risks to the financial system and the economy and to better analyze how banks operate under the new conditions

**Phase I**  
(from July 1, 2021)

- **LT refinancing loans**: the **maximum maturity** reduced from 5 to 3 years.  
  **Auction volumes** decreased: to UAH 5 bn from July, UAH 4 bn from August, and to UAH 3 bn from September

- **Interest rate swap**: the **frequency of auctions** reduced from two times per month to once per month, with the **maximum maturity** decreasing from 5 to 3 years

**Phase II**  
(from October 1, 2021)

- Long-term refinancing and interest rate swaps were fully phased out. The last long-term refinancing tender was held on 10 September, and the last interest rate swap auction – on 29 September
The NBU expects inflationary trend to reverse. However, risks tilted to the upside. Historical evidence proves that

**Headline inflation, %**

- CPI target band
- Quarterly change
- Annual change

**Components of Core CPI, y-o-y change, %**

- Processed foods
- Market services
- Clothes & footwear
- Other non-food

Source: SSSU, NBU staff estimates
Components of CPI are frequently moving in divergent directions

CPI components, % yoy

Core CPI components, % yoy

Source: SSSU, NBU staff estimates.
Services are usual drives of inflation due to structural imbalances on the labor market and migration

- The growth of wages puts pressure on production costs, especially in services sectors
- The opening of borders, made possible by the vaccine rollout and economic recovery in Europe, resumed interest and ability to work abroad in 2021
- Supply and demand mismatches in the labor market intensified after the COVID-19 crisis, also contributing to an increase in wages in some sectors
Processed and raw food prices heavily depend on harvest and global price developments

- High world food prices offset the effects of high yields as Ukraine is a small open economy
- Sticky consumer demand and rising energy prices have also intensified inflationary pressures
Administrative inflation is high and volatile. It will maintain these features in the future.

Components of administered inflation, % yoy

- Alcohol and tobacco
- Transport services
- Natural gas (RHS)
- Hot water, central heating (RHS)

Natural gas prices, 04.2019 = 100

- Netherlands TTF prices (UAH eq.)
- Consumer prices
- Prices in oil and natural gas extraction
- Prices in oil and natural gas extraction

Administrative restrictions, such as the fixing of natural gas tariffs and the limitation of the margin on the price of petrol and diesel, restrained the direct impact of rising energy prices on inflation in short-term.

However, this leads to the accumulation of imbalances and the possibility of rapid adjustments in tariffs in the future.
The FX channel is the most powerful for disinflation

Underlying inflation trends, % p/p

Official exchange rate, hryvnia REER and NEER indices

Source: SSSU, NBU staff estimates.

Source: IFS, NBU’s estimates.
Holding commitment to floating exchange rate is essential in disinflationary process.

- Q1: + USD 271 million
- Q2: + USD 533 million
- Q3: + USD 676 million
- Q4: + USD 1472 million
If pro-inflationary risks materialize, the NBU stands ready to raise its key policy rate

Key rate, %

CPI, annual change, %

Source: NBU staff estimates.

* The forecast is given in a fan chart. This chart type is used to illustrate uncertainty with regard to predicted future values. For instance, the probability that the indicator will be in the range of the darkest shaded area in the chart (around the central line) is 30%. The same applies to other chart areas, implying the 90% probability that the indicator will be in the range of the lightest shaded area.