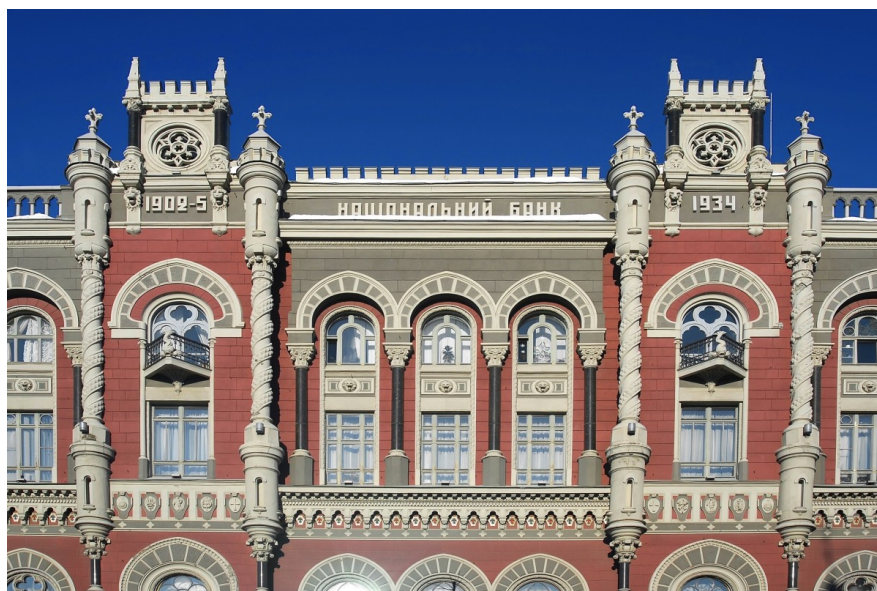


Ukraine: NBU minutes – turning growth supportive

The decision to cut the key rate from 11% to 10% underlines a mild departure from a strict inflation-targeting regime towards a more growth-supportive policy stance



The National Bank of Ukraine held its Monetary Policy Committee on 11 March, a time when the Covid-19 developments were still regarded by the MPC as having “ a limited and neutral impact on the Ukrainian economy”. Two days later the first death caused by coronavirus occurred, three days later the borders were shut to foreigners, on 19 March a state of emergency was declared in the Kiev area and is now under discussion to be extended to the entire country.

On the economic front developments have been fast and negative as well, with business activity coming to a sudden stop in most sectors. This created a new-found urgency for the Ukrainian government to push forward an IMF loan, part of which to go directly into the state budget. Speaking of the budget, officials now see a -7.0% of GDP budget deficit in 2020 while on the GDP side, the only question is how big the contraction will be.

It's not only about inflation

Why mention all of this? Because the seven MPC members who voted for a 100bp cut of the key

rate to 10% seem to have considered not only that “inflationary pressure eases faster than predicted” but also that “the NBU should ease its monetary policy to support Ukraine’s economy”. And with the economy going into recession, the latter argument will probably be used at future MPC meetings as well. Better prospects of having an IMF agreement sooner rather than later, corroborated with “sufficient” international reserves have enforced the members’ view that the NBU can go ahead with policy easing.

Balancing FX and rates

On the FX topic, it has caught our attention that the NBU could intervene to “smooth out excessive exchange rate fluctuations that are fueled by psychological factors”. This suggests that the central bank could allow for a hryvnia depreciation as long as it is triggered by non-psychological factors (presumably a natural supply/demand mismatch generated by real flows). Although we do not expect a dramatic change in the NBU’s FX-centered monetary policy, it seems that there is a bit of room to shift the focus from FX towards interest rates, particularly if the economy will require this.

Our base case right now is that Ukraine will sign an agreement with the IMF within the next 2 months, which will allow the NBU to continue its interest rate cut cycle while preserving a relative stability of the hryvnia. We maintain our call for an 8.0% terminal rate this year. The FX rate could be allowed to spike above 28 at times, but we continue to believe that the 27-28 range will remain the main “battlefield” for the NBU in the upcoming months, with 30 likely seen as a “hard-limit”.

Author

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user’s investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by

the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.