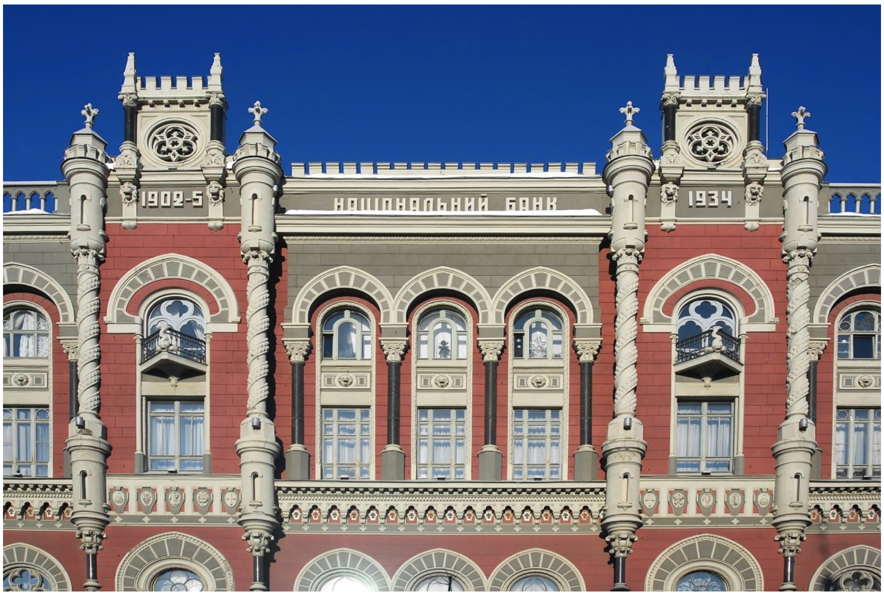
Ukraine: NBU minutes – turning growth supportive

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 the that the NBU could intervene to "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".

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