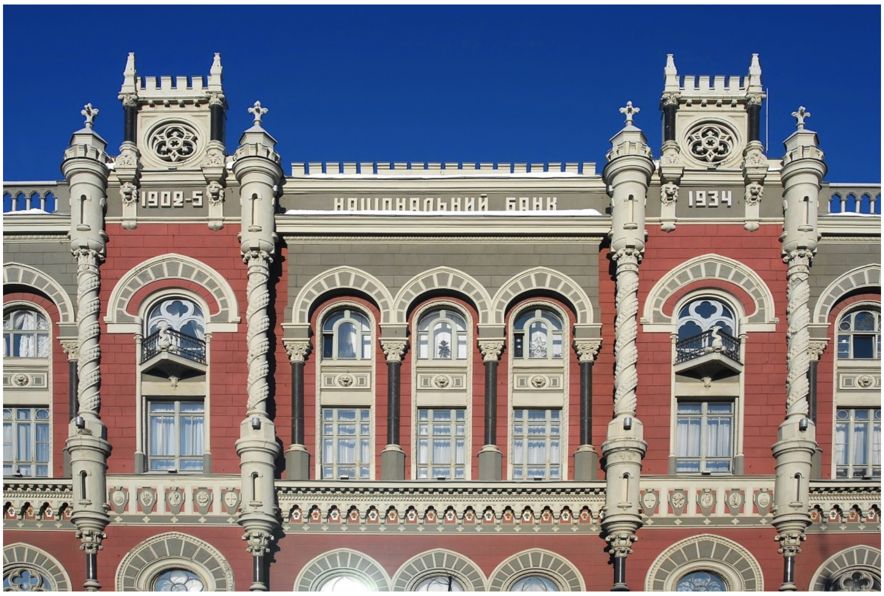
Ukraine: proving independence by tightening

The National Bank of Ukraine (NBU) unexpected rate hike aims not only at taming inflation, but also pressing the government to deliver on promises to the IMF.



16%

NBU key rate

Up from consensus/previous 14.5%

Surprising the market for the third time since October 2017

After two surprising 100bp rate hikes in October and December (from 12.50% to 14.50%), the NBU stuck to the same path and hiked the key rate by 150bp to 16% against the consensus call of "on-hold". It cited the need to bring inflation to the target range (8% ± 2 ppt) and to offset inflation risks from increasing raw food prices, high inflation expectations, notable easing of the government's fiscal policy and risks of further delays in the IMF's disbursements.

Given the Dec-17 inflation data (headline CPI of 13.7% YoY vs 12.4% in 2016) and potential inflation risks, the NBU has again increased its CPI forecast from 7.3% to 8.9% by end-2018. Yet, the NBU has stated that tight monetary policy is expected to slow down inflation to the target by mid-2019 reaching the level of 5.8% by end-2019 (5.0% before).

Also, the NBU upgraded its GDP growth from 3.2% to 3.4% in 2018 mostly due to rising private consumption driven by further increases in real wages and social benefits. Yet, the NBU has revised its estimates for 2019-20 down to 2.9% from 3.5% initially expected by end-2019 due to fading effects from this year's fiscal policy loosening and tight monetary policy approach.

Finally, the NBU once again mentioned the cooperation with the IMF as a crucial assumption for the Ukraine's macroeconomic stability. It even plans to initiate talks on a new programme given US$16bn of external debt payments due in 2018-20. The regulator still expects to get US$2bn in 2018 from the IMF vs the Oct-17 expectations of US$3.5bn. In turn, the NBU has lowered the forecast for foreign reserves to US$20.5bn from the initial US$22.2bn for 2018 and to US$17.8bn from US$21.2bn for 2019.

No reforms means more tightening

The poor inflation story has clearly been a source of concern, together with mounting risks of not completing the current IMF programme and, thus, not getting required external funding, which seems to have justified the extra policy tightening. By doing this, it clearly tries to address the inflation risks from further UAH weakness, a longer inflation overshoot, higher inflation/devalution expectations and easier fiscal policy all stemming from the government/Parliament-driven delay in fullfilling the IMF requirements. And, as it explicitly states, this is not only about inflation but also about overall financial stability risks (read inability to service future debt payments).

Risks of populist political decisions against the IMF requirements are clearly there ahead of the 2019 election cycle given the latest inability/unwillingness to deliver on the current IMF question marks. And the NBU clearly tries to play in advance proving its independence and pressing the government to restore the right course. Hence, we have a pledge to continue tightening if the government makes no action beyong the right words. But it is always more dificult to have a strong view when it comes to politics.