

Ukraine Watch: NBU cut its key policy rate contrary to all market forecasts

The NBU cut its key policy rate by 50 bp to 14.5% and further reduced other key policy rates. This indicates that the NBU is approaching a "fine-tuning" regime in its monetary easing cycle. We maintain our key policy rate forecast of 13% at the end of 2024.

NBU cut its key policy rate contrary to all market forecasts **1**

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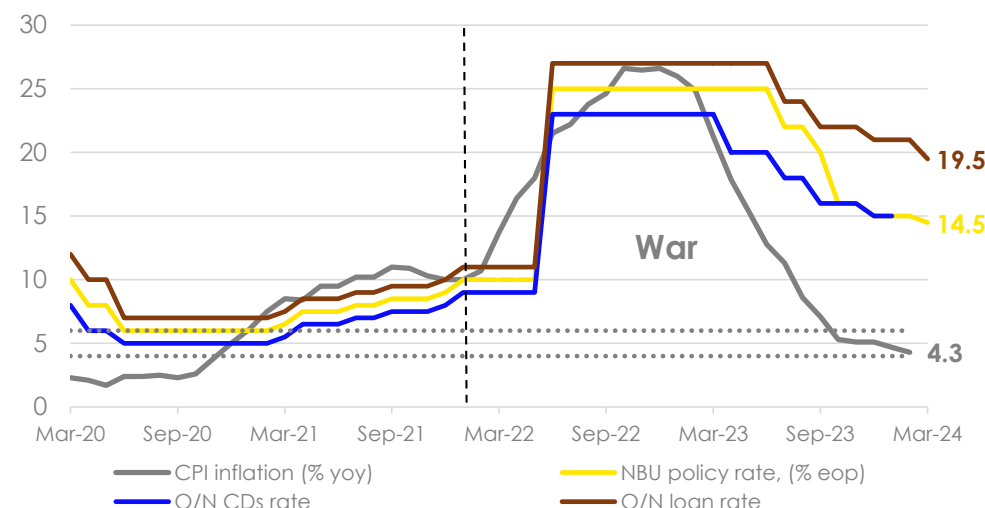
Analyst **6**



NBU cut its key policy rate contrary to all market forecasts

The decision of the NBU to cut its key rate by 50 bp to 14.5% came as **a great surprise** not only to us but **to the whole business community**. Indeed, **the NBU sent clear signals at previous meetings that unchanged core rates** of monetary instruments would be in place **at least until the end of the second quarter** on the back of substantial potential risks tied to defence and financing risks. Therefore, **we can treat the recent NBU decision as a signal on the changed approach** of the regulator towards the probability of further sharpening in core risks preventing more rapid easing of its monetary policy.

Chart 1 - Inflation and NBU policy rates



Source: Ukrstat, NBU, RBI/Raiffeisen Research

Besides the simultaneous cut in O/N CDs rate (which is pegged currently to the key rate), **the NBU also changed two other working rates more substantially**: by 150 bp on both three-month CDs (to 17.5%) and on refinancing loans (to 19.5%). Indeed, this was the first change in working rates of monetary instruments since the NBU switched to the lower bound regime in its monetary policy. It is also worth looking at a rather cautious

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cut in policy rate (i.e. by just 50 bp) for the first time since the beginning of the war. This indicates that **the NBU is approaching a "fine-tuning" regime** in its monetary easing cycle, thus making rather small steps in order to see the reaction of the economy to proposed changes.

As inflation came in below NBU forecast for the first two months of the year (thus even deepening below the targeted level), NBU officials explained that **the significant mitigation of the risks of insufficient external financing and signals of stabilisation in the FX market were the core drivers for the rate cuts**. We can see again here two important signals. First, the gap in external financing for the whole year (due to no decision on external aid from the US) is not strong enough (at least in the coming few months) to influence negatively financial and fiscal stability. In particular, Ukraine is expected to receive about USD 10 bn from international donors in the coming two months, which we believe should seriously replenish NBU FX reserves. Second, current volatility in the FX market (especially recent spikes in the official exchange rate to new historical maximums) is not treated by the NBU as a worrisome trend. Moreover, we believe a solid reduction in NBU interventions in FX market in late February (despite heightened security risks and visible disruptions in foreign aid flows) might be clear evidence of stabilization in the FX market,

The NBU emphasizes that it will continue the cycle of monetary easing in case the risks to inflation and exchange rate stability are sustainably reduced. However, we believe that improved security risks and increased external financing could be an additional trigger in the coming months for a slight cut in the policy rate. However, although the current decision of the NBU was not in line with our expectations, it **remains fully consistent with our forecasts** of a key rate of 13% by the end of 2024.

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Ukraine:

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Sell recommendations	15.0%	17.3%	

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