Inflation targeting - rationale for the Ukraine to move to a new monetary policy framework after the crisis

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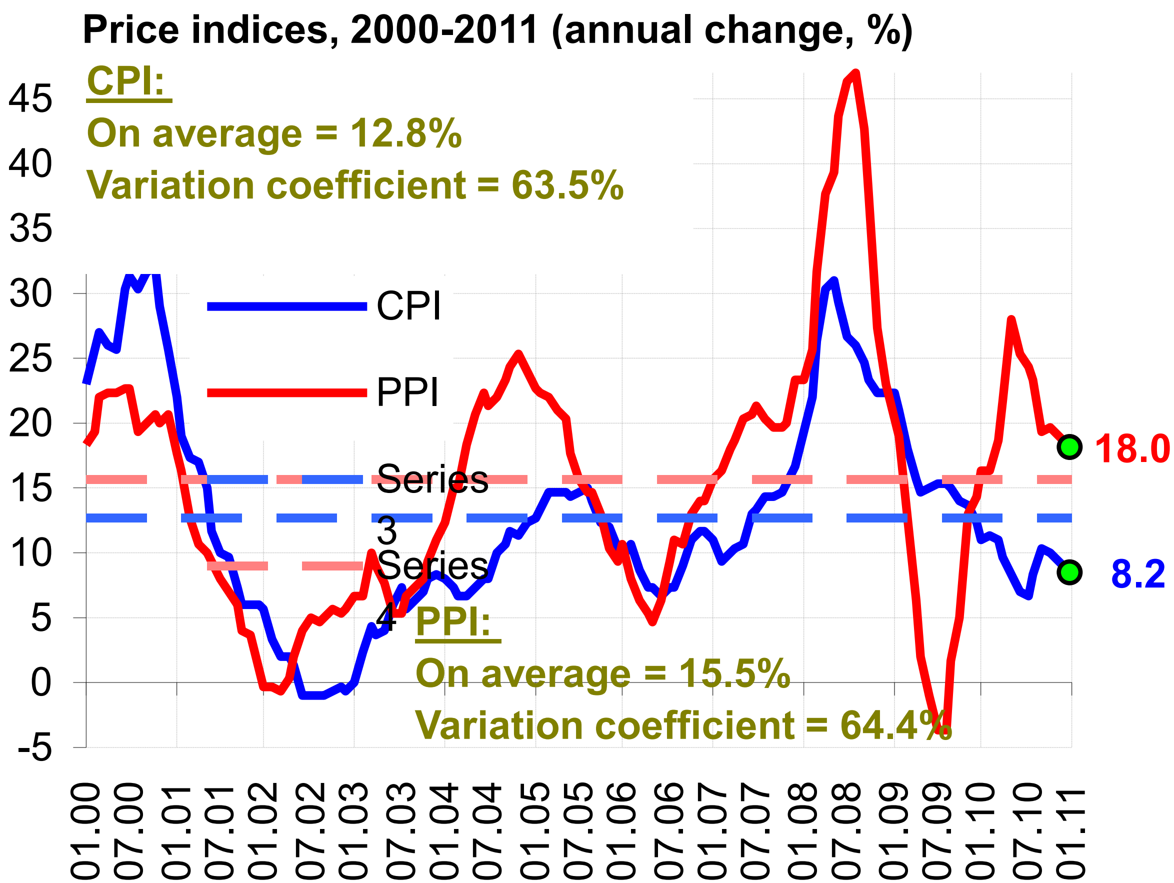
The Rationale for Transitioning to the Inflation Targeting Regime in Ukraine

- High and instable inflation
- The need for a new long-term monetary paradigm to provide support to long-term innovation growth and development as well as fair income distribution
- Willingness to pursue an independent, anti-cyclical and shock-absorbing monetary policy
- The need to enhance economic resilience against foreign exchange and financial crises
- The need to liberalize the BOP financial account and for integration into the world financial environment
- Countries are increasingly introducing IT and demonstrate its efficiency

High and Instable Inflation

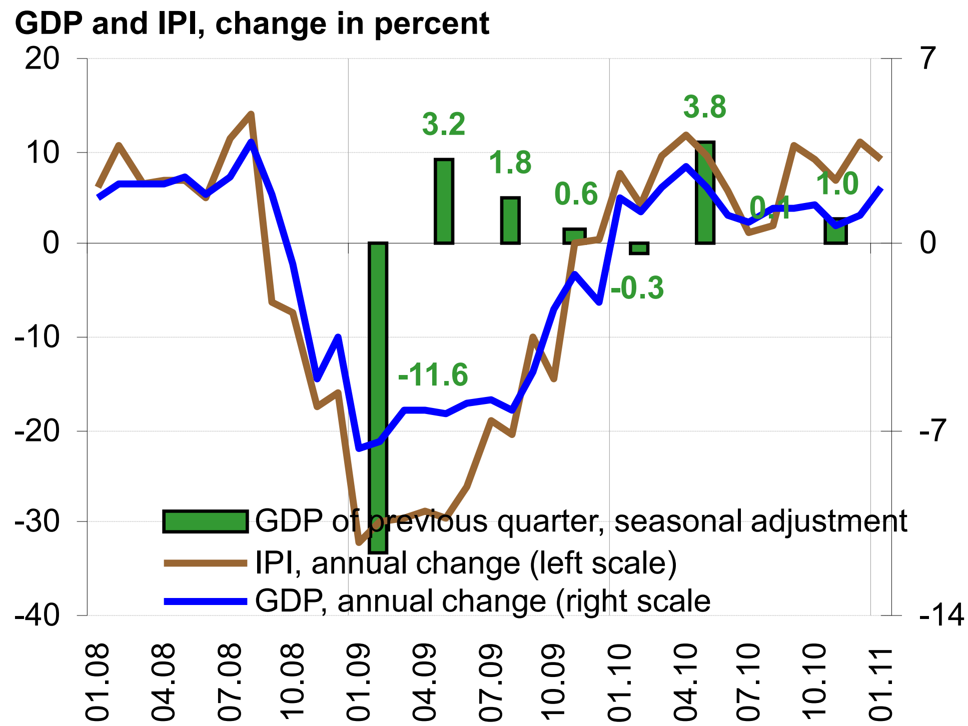


Source: State Statistics Committee and own calculations

High GDP Volatility Driven by Dependence on External Economic Conditions

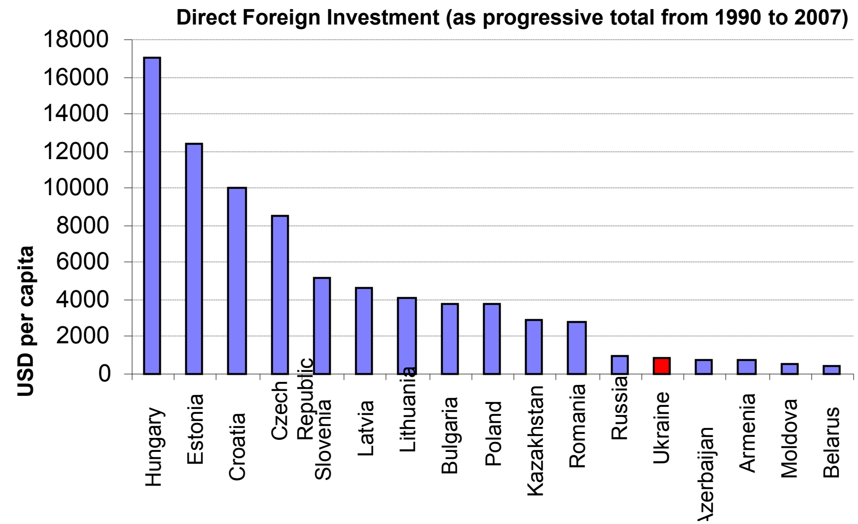
GDP dynamics were largely determined by:

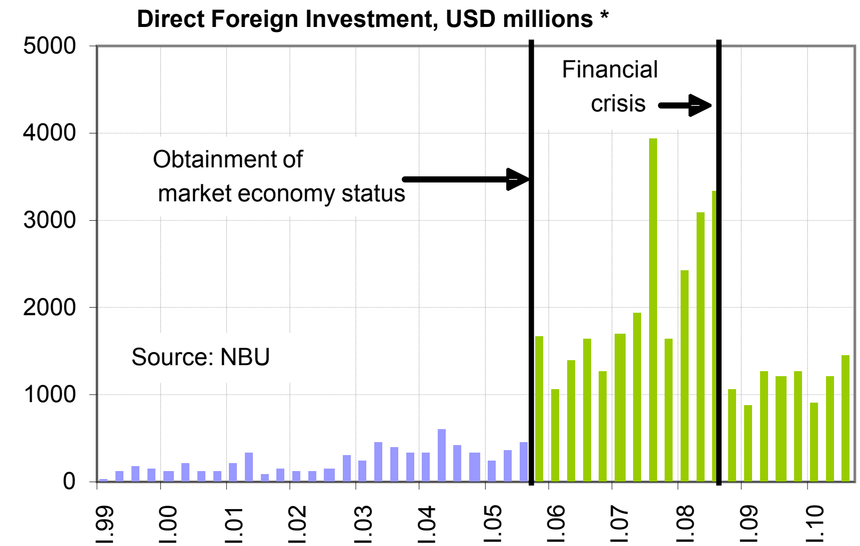
- favorable external conditions
- rising world metal prices (stimulated industrial growth and accordingly related branch growth)
- High economic openness triggered pronounced economic development variability depending on external conditions



Investment Potential is Realized Very Slowly

- Ukraine has continued to rank one of the lowest in foreign investment;
- The situation has improved markedly after Ukraine was recognized as a market economy;
- The global liquidity crisis has led to an appreciable reduction in foreign direct investment earnings.

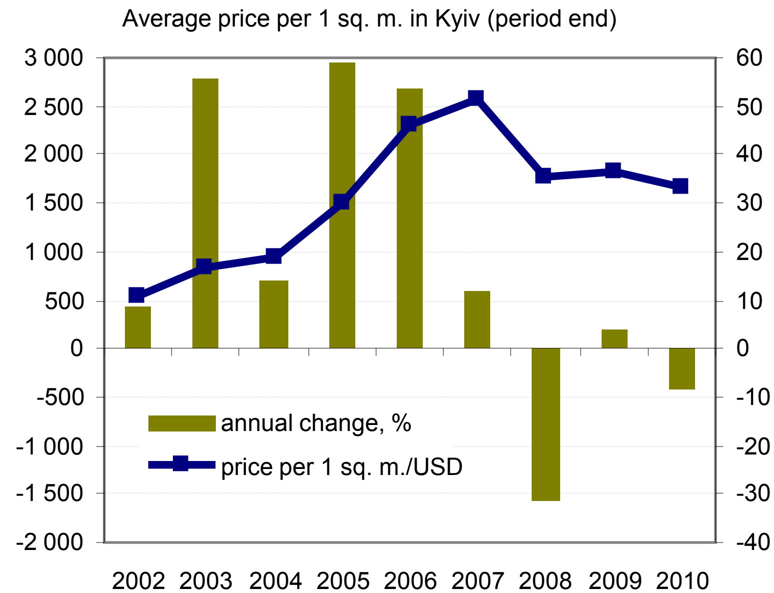




* IV.05 does not include proceeds from Kryvorizhstal sales. Total – USD 6474 million

The Real Estate Market Was a "Bubble"

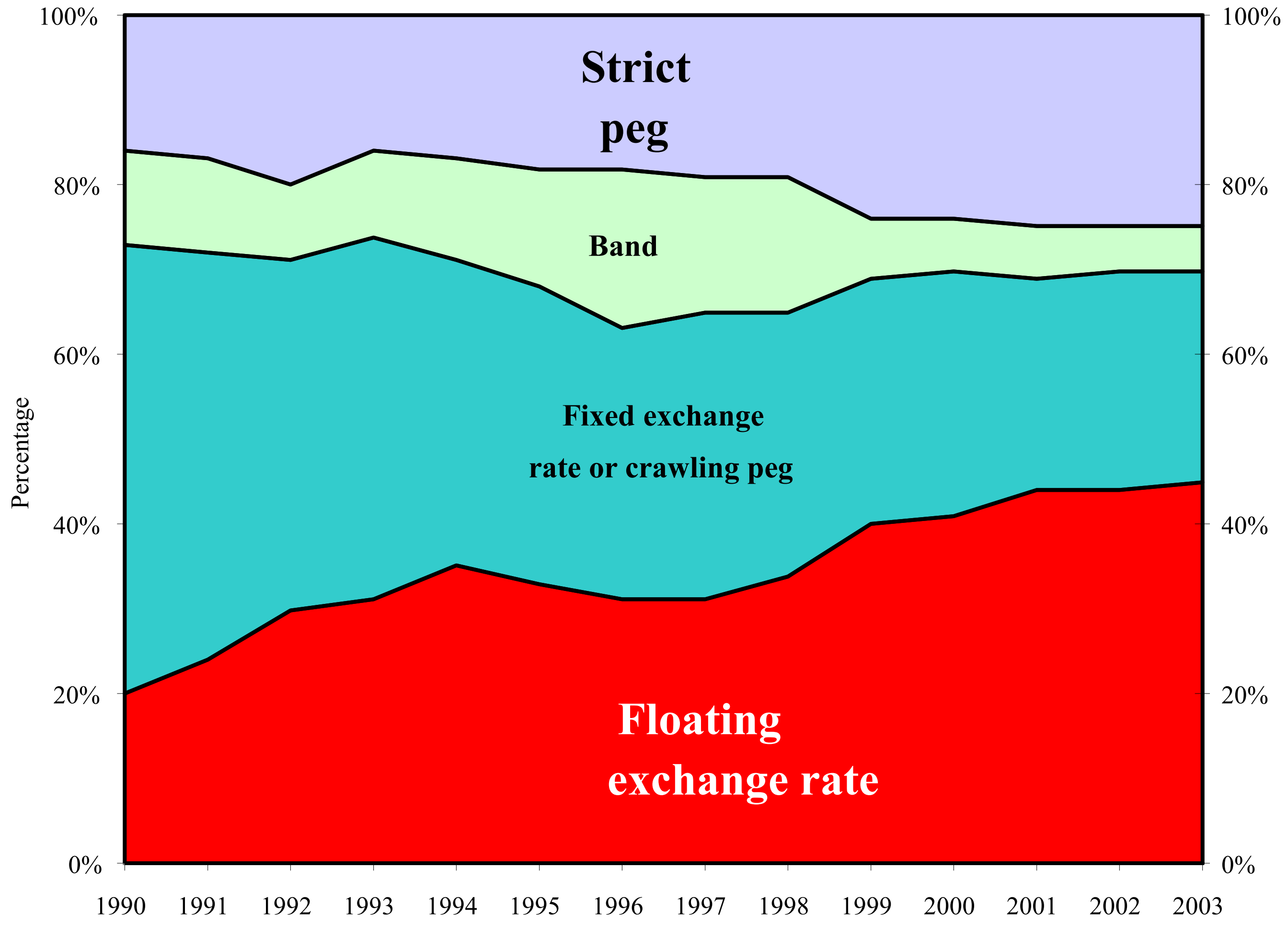
- Skyrocketing real estate prices and no investment alternatives resulted in the accumulation of a significant portion of lending resources in the real estate market;
- A substantial portion of foreign currency real estate loans envisaged great risks to the banking system because of possible difficulties with repayment of speculative loans;
- The 2008 - 2009 "bubble" burst caused bank balances to deteriorate markedly in the wake of a growing proportion of negatively classified loans.



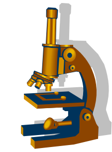
Willingness to Pursue an Independent Monetary Policy in Ukraine

- –The monetary policy is not actually independent taking into account the fixed exchange rate and de facto increasingly open financial account
- –There is a need for an independent policy to meet shocks and to agree fiscal policy with monetary policy
- –Inflation targeting is problematic with an uncertain impact on the inflation
- –A fixed exchange rate and large capital inflows increase inflationary pressure and undermine financial soundness
- –A flexible exchange rate along with targeted internal price stability allow to solve many of these problems

Economies Do Transition from Fixed to Floating Exchange Rates



The Number of Economies Doing Inflation Targeting is Constantly on the Increase



Developed economies	Introduction date	Developing economies	Introduction date
New Zealand	1989	Chile	1990
Canada	1991	Israel	1991
Iceland	1991	Peru	1994
Great Britain	1992	Czech Republic	1997
Australia	1993	Poland	1998
Finland	1993*	Brazil	1999
Sweden	1993	Mexico	1999
Spain	1994*	Republic of South Africa	2000
Switzerland	2000	Thailand	2000
Norway	2001	Columbia	2000
		Korea	2000
		Hungary	2001
		Philippines	2002
		Slovakia	2005
		Turkey	2005
		Romania	2006
		Serbia	2006
		Armenia	2006

*Before joining the euro area

Current risks facing Ukraine

- Expansionary policy persists
- The economy remains heavily dependent on terms of trade (metal and Russian gas prices)
- The financial stability of the banking system is unsatisfactory (a large proportion of bad loans)
- The inflation remains too high
- The crisis worsened external borrowing terms
- In the case of another world crisis wave the chance of “soft landing” remains but with the probability of “hard landing” rapidly increasing

Thank you for your attention!