

Partnership Approaches in Fighting War-Generated Inflation in Ukraine

By Yaroslav Zhalilo, Dr.Sc., Distinguished Research Fellow, GLOBSEC

Summary

Inflation, which soared in Ukraine due to active Russian aggression, is a particular case of the global trend of inflation, caused by prevailing non-monetary factors. In order to cope with, the complementary actions of stakeholders, capable to influence on the inflation drivers, should be provided at the partnership basis. The paper refers to the desired agenda of such actions, and prospective partnership of Ukrainian and European actors.

Problem

Unconventional inflation, whose factors are beyond the monetary sphere, becomes the main trend at the global level in last years. Logistics shocks and supply bottlenecks, caused by COVID-19 crisis, followed by the consequences of pro-active monetary and fiscal policies of pandemic period and post-pandemic revival, impact of “hot” war in Ukraine and Putin’s “hybrid” actions at energy markets cause sharp increases of prices through all over the world. The global inflation in 2022 is **forecasted** at 8,8 % - 4,85 points more, than forecasted at the beginning of the year and 4,1 points more than in 2021.

In Ukraine the direct consequences of the war caused a prevalence of trends of unconventional inflation. Wholesale and retail prices have soared due to more expensive logistics (also taking into account higher prices for fuel), higher prices for imported consumer goods and production components, lost supply segments from occupied or attacked territories, much higher risk premiums, unfavorable inflationary expectations and speculative (rush) consumer behavior for some goods.

The high monetization of the budget deficit creates monetary prerequisites for realization of the described factors of inflation, but is not the initial cause of this.

The government’s decision to pause the rise of regulated prices for utilities impeded this segment of inflation, but released some money to feed potentially excess consumer demand.

The conventional anti-inflationary policies are incapable to influence the modern inflationary factors. The principal emphasis should be done at the *institutional adaptation* to the new challenges – in large extent, this requires significant investments in structural changes and infrastructure modernization.

Coping with unconventional inflation, different countries tend not to limit with the classical measures of strict monetary policy, supplementing the gradual key interest rates’ increases with strategy-based complementary actions, targeting the adaptive capacity of national economies and mitigating negative social trends (See **Annex 1**).

The National bank of Ukraine (NBU), faced with inflation splash, attempts to continue applying the policy of inflationary targeting (IT) established in previous years. This was evidenced most recently by **June decision** to sharply increase the discount rate from 10 to 25 %.

Since February 24, the role of a powerful anti-inflationary anchor has been played by the fixation of the hryvnia’s exchange rate at the pre-war level.

The **forced devaluation** by 25 % since July 21st influenced as inflationary accelerator.

Meanwhile, the strict monetary policy (the **NBU declares** keeping the discount rate at the level of 25 % until mid-2024 despite forecasted inflation of 9.4 % in 2024) is not consistent with the goal of supporting economic activity in the short run and active investments in recovery and structural changes in the medium and long terms. **This impedes the adaptive capacity of stakeholders, thus, deteriorates the prospective to cope with unconventional inflation.**

Purpose

In case of prevailing unconventional inflation, the Central bank can reach its inflationary targets only due to structural reforms in the economy, **based on the adaptive institutions**. Thus, in the wartime in Ukraine it is necessary to implement the **corrective shift in anti-inflationary policy**, which should envisage the **broad scope of non-monetary instruments**, complementary to anti-inflationary measures of the Central bank as more capable to deal with the systemic institutional factors, feeding inflationary trends. This complementarity allows, to unload the monetary authority from anti-inflationary urgencies and to provide more growth-friendly policy in the short period; in the medium run – to restore the capacity of the Central bank to manage inflation, not endangering the economic recovery and growth prospective.

Recommendations

The optimal way to embrace the multilayered tasks of adapting to new challenges is to involve the main stakeholders, which are the most efficient in reaching partial goals, crucial for coping with unconventional inflation, into common play, as partners, fulfilling the specified tasks within their best competence.

An approach of anti-inflationary partnership should be based on the principles (see **Annex 2**), which presume a **common anti-inflationary goal and distributed tasks of main partners**, multiplying the individual capacities of stakeholders in complementary actions.

To activate the stakeholders' roles in counteracting inflationary trends, the following special actions of stakeholders are recommended.

1. The National (Central) Bank

- **Goals amendment.** Being fully independent in determining operational goals and choice of instruments of monetary policy, the NBU should be more involved in the policy of economic recovery. This requires amending the **statutory goals of the NBU**. For now, these presume hierarchy of goals: stability of national currency, banks stability, economic growth, while each next goal is accepted only if the previous one is fulfilled. Instead, seems more productive to formulate the goals similarly to US Federal Reserve or European Central Bank. In particular, the **Fed maintains** “long run growth of the monetary and credit aggregates commensurate with the economy’s long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates”. In its turn, **ECB** keeps “prices stable, thereby supporting economic growth and job creation”. In this case, the economic growth and inflation can be considered as performance indicators for price stabilizing (anti-inflationary) policy.
- **Differential instruments.** As banking sector regulator, the NBU should strengthen the influence on channeling money through the banking system, in order to mitigate its inflationary impact. For this reason, the NBU should reduce the interest rate of refinancing commercial banks with a large share of long-term crediting investment projects. The implementation of the European experience of **Targeted Longer Term Refinancing Operations** (TLTRO), practiced by the ECB since 2014, should be supported. During the period of recovery, the preferences also could be suggested to the banks, crediting the critically important industries (energy and transport infrastructure, construction, etc.).
- **Better Communications.** Policy coordination of NBU with government institutions (primarily, Ministry of Finance and Ministry of Economy) should allow balancing fiscal and monetary actions, avoiding undesired splashes of liquidity, generated by Government spending, and weighting debt financing of the budget deficit. In this task, the **NBU Council** should be engaged, with strengthened competences and broader responsibilities.

2. Commercial banks

- **“Hot money” absorption.** Implementation of attractive term deposit programs, encouraging bank savings and avoiding excess “hot money” pressure on the sensitive markets – currency, precious metals, durable goods, etc. For the moment, the ratio between term and on demand deposits **dramatically changed** in favor of the latter, thus short-term banks’ resource prevails, demotivating long-term crediting. Additional stimuli of savings can be presented by combined savings-insurance programs.
- **Targeted crediting.** The differential regulations of the NBU, special credit programs, subsidized by the Government and, prospectively, by international partners, should channel money supply for servicing extended turnover, and avoiding direct reinforcement of “hot money”.
- **State-owned banks’ leadership.** The state-owned banks, responsible in mid-2022 in Ukraine for **one half of the net assets of the banking system**, should play the role of trendsetters, supplying attractive banking products on both deposits’ and credits’ sides, as mentioned above. This requires the activation of the Government’s role in the banks’ strategic management.

3. Government

- **Markets’ performance support.** Fighting the **informational asymmetry** as one of the principal causes of unconventional inflation due to misaligned expectations, the Government institutions, based on systemic monitoring and partnerships with business associations, should ensure the unlimited turnover of marketing information (on prices, supply proposals and demand prospective) for markets’ transparency; promote framework (information exchange, official and expert assessments and forecasts) to rationalize expectations of consumers and businesses.
- **Trade logistics development.** The promotion of wholesale logistics and retail development will reduce the costs of traders and remove the obstacles of commodities turnover to avoid local deficits. In war and post-war periods, the direct public investments or different kinds of financial support of the sphere seem reasonable in heavily damaged regions and at some sensitive markets.

- Ensuring of fair competition. The Government should implement the **modern instruments** of monitoring, revealing and prevention of non-competitive behaviour with special accents on competition promotion (where possible) in cost-defining sectors (utilities, fuel supply, transportation) and at food market. The proper oversight over the validity of tariffs of highly monopolized sectors (electricity, gas, heat, water supply, telecommunications, etc.) should be complemented by the control over the quality of services and by the requirements of services’ provision resilience.
- **Costs reduction.** The price increases, caused by soaring energy prices, can be mitigated by investments in energy efficiency improvement, including energy-steered modernization of buildings, improvement of energy and heat generation and supply, involvement of alternative/local energy sources, “smart” networks, etc. For key sectors, the Government can invest directly, otherwise – promote investments with special subsidized credit programs, tax preferences for investors, informational and methodical support of local public investments.

4. Businesses

- **Management compliance.** Mitigating the risks of unconventional inflation requires the business management compliance with the challenges, caused by new inflationary factors. Widescale training and consulting support of business optimization in wartime period (in particular, faced scarce energy supply, uneven logistic, personnel deficit, etc.) allows to reach business adaptivity as anti-inflationary factor.
- **Market logistics improvement.** Market logistics adapting to wartime challenges (e.g. alternative supply chains, distributed warehouses, additional storage capacities for agriproducts, supply of fuel, resilient retail, etc.) should significantly improve flexibility of businesses and reduce pressure on costs, which push the prices up. The appropriate investments can be done directly by businesses or in consortium with central and/or local authorities, either with international financial support.
- **Innovative technologies.** Ukraine can be a prospective case for the implementation of innovative technologic solutions, crucial for adopting to actual challenges, reducing costs

and promotion of business adaptivity – in energy supply, logistics, telecommunications, flexible production lines and the like. Thus, this represents a prospective field for cooperation with European partners, incl, using donors' support.

5. Local authorities (self-governance)

- **Local costs management.** To reduce the inflationary component, born from locally supplied services, makes sense to improve the performance management in these spheres (water and heat supply, sewage, waste management, social services), reducing costs of local services' provision. The capacity of local communities to invest in energy efficiency, organizational improvements (like "smart" grids), more productive equipment might be supported by targeted central Government programs, and in P2P communications with the municipalities of donor countries.
- **"Last mile" support.** The local authorities can palpably reduce the costs of businesses, improving the organization of "last mile" delivery to customer's hands: by investments in transport accessibility, retail in areas with low density of customers, by provision of informational support of order/delivery platforms. For many services the "last mile" promotion is built in "smart" cities/communities.
- **Local business promotion.** Better capacity of local business to improve the response on local demand can essentially reduce the costs of logistics, that soared in wartime, increase goods and services' supply, improve the resilience of local businesses. A wide variety of measures – from supply-demand informational platforms – to joint investments in local businesses (including attraction of small-sized foreign investments, promoted by P2P intermunicipal communications) will be supportive to deal with unconventional inflation.

6. Civic institutions and business associations

- **Public oversight of competition.** The business associations, especially those with sectorial specialization, can be supportive for qualified market oversight and unfair competition prevention, acting in tight communication with competition-promoting Government entities (primarily, Anti-monopoly Committee). The **best practices of EU countries** can be promotive in the case.
- **Market information dissemination.** The business associations can do a big deal in the collection, production and dissemination of information concerning market conditions, analysis and forecasts. This can reduce transaction costs of businesses and optimize expectations. This activity can be promoted by coordination with governmental informational platforms and services. At the international level, the business associations can provide the exchange of business and investment opportunities with European partners.
- **Rationalizing behaviour.** Civic and business institutions can provide informational campaigns, trainings, other types of promotion (e.g. grant programmes, contests, presentations, study trips etc.) for both businesses and consumers (incl. young people) in energy saving, social responsibility, rational consumption, green production, market and financial literacy, labour market behaviour, any other possible spheres, able to defuse the drivers on unconventional inflation.

7. Individuals

- **Responsible consumption.** Based on accessible information, individuals (households) can rationally build their behaviour with responsible waste management, avoiding abundant consumption, rationalizing the load on environment and infrastructure – thus, reducing the costs' burden of appropriate services' providers.
- **Rational demand.** An important part of responsible consumption is the consumers' ability to rationalize the amounts and timeline of their purchases, in particular - withstand to rush

purchases, which naturally cause local deficits and excess load on logistics.

- **Adaptation to challenges.** In accordance with actual challenges – primarily, war-borne security and resilience risks, but also taken into account the global ones, like climate changes, pandemic and others, the individuals should modify their market behaviour, preferences, propensities to consume and save, etc. The changing demand will drive the supply side, promoting the adaptation of businesses.

Conclusion

The complex nature of unconventional inflation, evolving in Ukraine in the time of widescale war, requires complementary actions, spread much beyond the monetary sphere and embracing all circle of main stakeholders, capable to mitigate the influence of the drivers of inflation. These actions should be provided at the basis of systemic anti-inflationary partnership. Organizationally, the latter should be realized at multiple levels as follows:

- implementation of anti-inflationary goals into **national strategy** (e.g. **National Recovery Plan**);
- implementation of anti-inflationary strategy goals and tasks into the **strategic agendas of partners** with mutual responsibilities defined;
- ensuring the **framework and clear algorithms of actions** of the partners to reach anti-inflationary goals;
- **involvement of international aid** to promote the capacities of anti-inflationary partners to cope with the drivers of unconventional inflation.

The actions, undertaken to deal with unconventional inflation in Ukraine, can represent a prospective ground for evolving of partnership between Ukrainian and European entities. At the same time, the experience, obtained at extreme case of Ukrainian war-borne inflation can be useful in medium- and long runs to deal with unconventional inflation in Europe.

Annex 1:

Some experience to deal with unconventional inflation

Strategic documents	Measures
The Inflation Reduction Act (USA, 2022)	Investments into the nation's social safety net, investments and tax credits for domestic energy production, combating climate change
Recovery and Resilience Facility (EU, 2021)	Inspiring EU governments into growth-friendly public investments in digital and green industries
EU countries' financial packages (totally more than EUR 280 bln)	Public transport subsidies (Germany), gas and electricity price caps, fuel rebates (France), transport subsidies, targeted aid to low-income people (Spain), income-related subsidies for health care and housing (Netherlands), benefits to vulnerable groups, subsidies for energy-intensive companies (Austria)
Anti-Inflation Shield (Poland, 2022)	VAT on basic food products, fertilizers, gas (0 %), electricity, heat (5 %), petrol (8 %), special gas tariffs for hospitals, schools, kindergartens, nurseries, and cultural institutions
Inflation-busting plan (Mexico, 2022)	Keeping prices of basic food products, exempting them from levying a general import tax, supporting the countryside with guaranteed agriproducts' prices and free fertilizers.

Annex 2:

The main principles of anti-inflationary partnership

- **Agreed goals** – presented by general strategy;
- **Reciprocity** - common principles and common values, based on common identity in national institutional system;
- **Tasks distribution** – general strategy goals, instrumentalized in local strategies and agendas of partners;
- **Tight communications** – consulting for complementary, harmonious concerted actions;
- **Mutual commitments and responsibility** – at the legal, political and voluntary (memoranda, etc.) levels;
- **Transparency and predictability** – open assessments of challenges and opportunities, clear algorithms of actions and announced plans;
- **Mutual trust** – as a result of predictability and responsibility;
- **Synergy** – multiplication of individual capacities in complementary actions.