Research

INFLATION AND MONETARY POLICY IN BLACK SEA COUNTRIES

Black Sea Bulletin
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Anastasia Chkhenkeli
Nika Kapanadze

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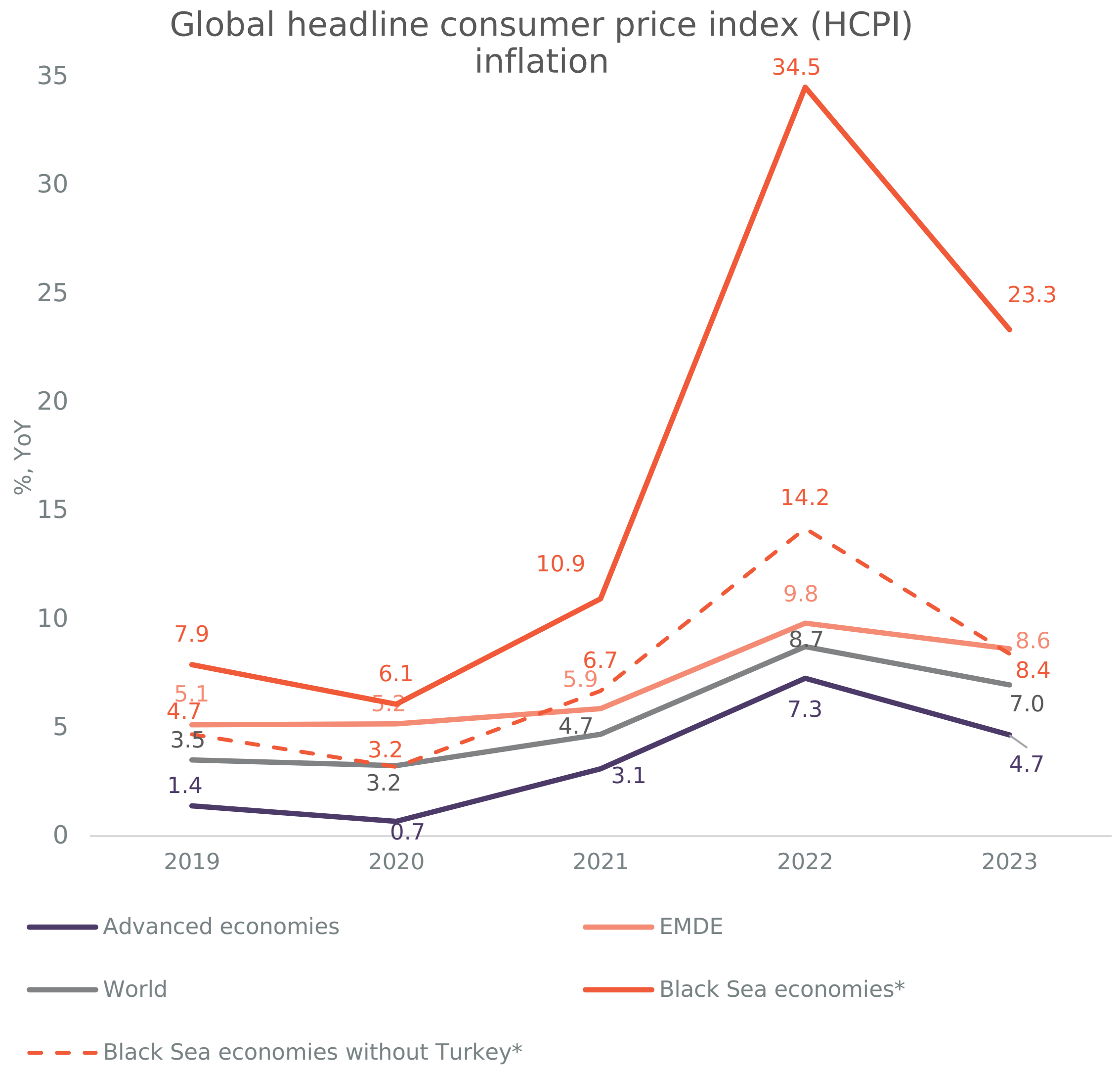
Introduction

- Since the outbreak of Russia's war on Ukraine, it has become essential to find alternative trade routes that bypass Russia to transport goods from the East to the West. In this regard, the Black Sea region has come under the spotlight with the Black Sea corridor highlighted as a potential option. In this context, it became even more important to analyse economic indicators and policy approaches implemented in Black Sea countries, which is the aim of this bulletin.

- Inflation has been running at multi-decade highs in many countries across the globe since mid-2020, when stringent restrictions were imposed to combat the spread of the COVID-19 pandemic. In 2022 in particular, inflationary pressures from pandemic-related disruptions were exacerbated by the Russo-Ukrainian War and spiking food and energy prices. In response, central banks implemented different monetary policy approaches in an attempt to stabilize the situation. Against this background, **recent inflationary trends and monetary policy approaches adopted by economically diverse Black Sea countries are analysed and compared in this issue of Black Sea bulletin.**

- The bulletin starts with a discussion of global inflation trends, before proceeding to overview of headline and core CPI in each Black Sea country from January 2020 till May 2023. It then advances to examine the monetary policy approaches adopted by the Black Sea countries. To conclude, the final chapter summarizes the inflation and monetary policy trends of Black Sea countries and provides some recommendations.

Global inflation trends



- **Inflation trends in the Black Sea region were in line with global inflation trends** – with decrease in 2020 (by 1.8 pp from 7.9 in 2019 to 6.1) and sharp spike in 2022 (from 10.9 in 2021 to 34.5 in 2022). And like global inflation, average inflation of Black Sea countries in 2023 while still remaining on high level (23.3%) is predicted to considerably decrease compared to 2021 (by 11.2 pp).

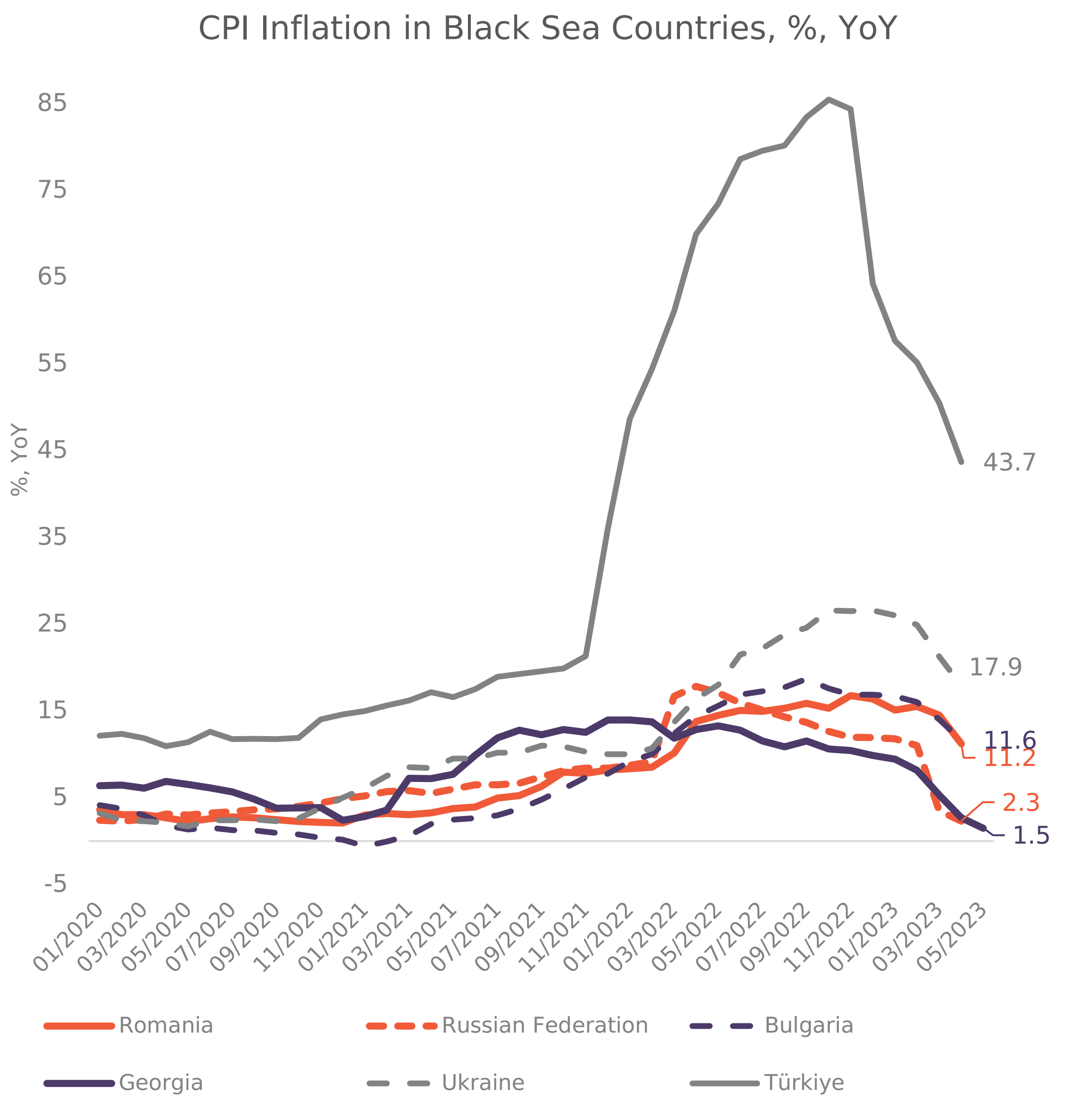
- The data also suggests that **inflation in the Black Sea region was higher than global inflation**, as well as higher than inflation in advanced economies and emerging markets and developed economies (EMDE), throughout the whole analysed period (2019-2023).

- Such a high inflation in the region is mainly attributed to Türkiye. Accordingly, **inflation for Black Sea countries excluding Türkiye** is much lower. In 2021-2022 even excluding Türkiye inflation of Black Sea region was higher than global inflation and inflation in EMDE (and obviously much higher than in advanced economies). Though in 2023, average inflation in Black Sea region excluding Türkiye is predicted to decrease to 8.4% which is slightly below the average inflation for EMDE (8.6%).

Source: International Monetary Fund (IMF), World Economic Outlook Database, April 2023

** The average inflation in Black Sea region is calculated by PMC RC using IMF data by weighting inflation of each country of the region by GDP valued at purchasing-power-parity*

Inflation in Black Sea countries

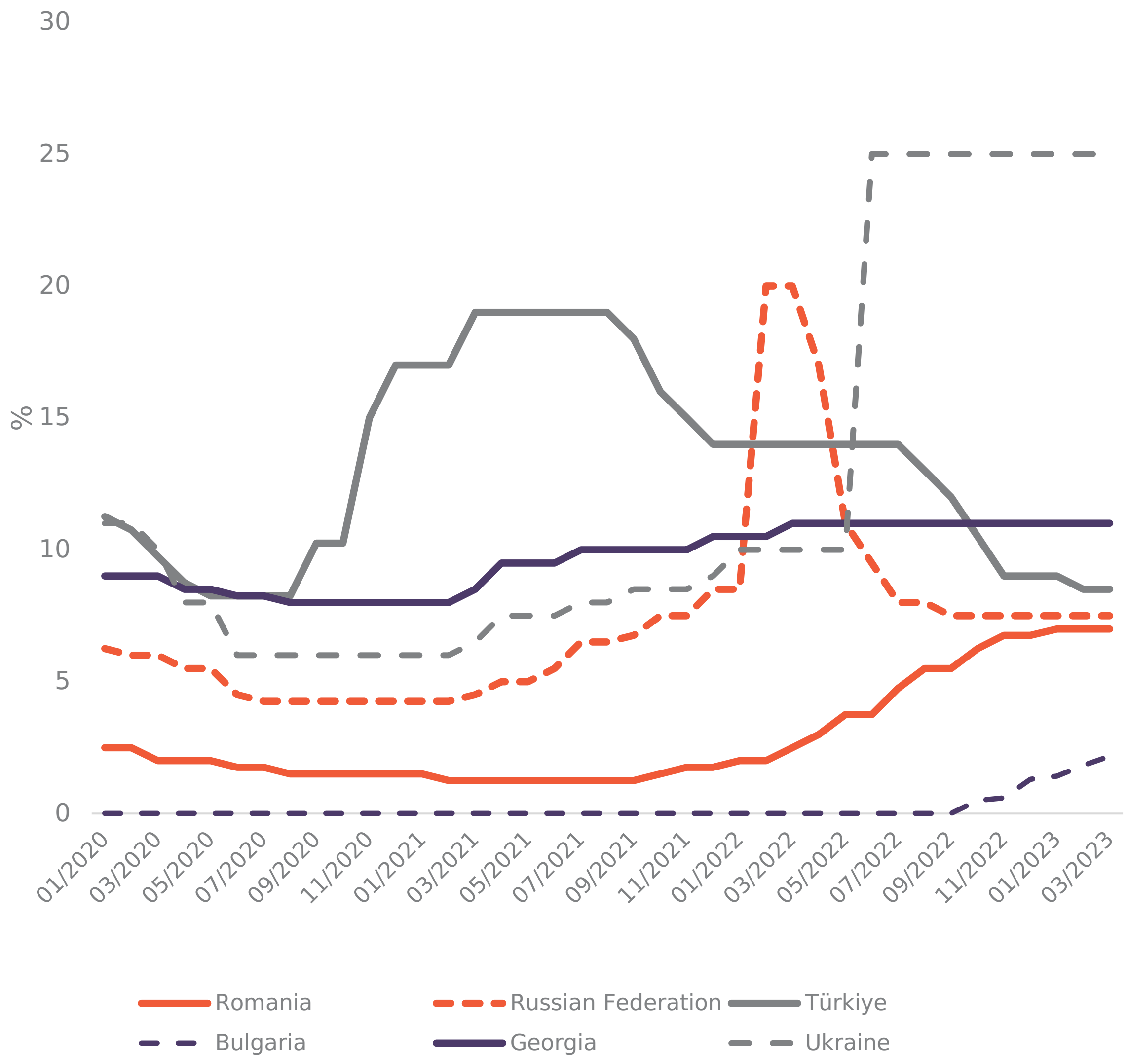


Source: National banks of Black Sea countries, May 2023

- Looking at CPI inflation trends in Black Sea countries from January 2020 until May 2023, **Türkiye** emerges as an outlier in the region. Türkiye stands out for its extraordinarily high level of inflation not only in a Black Sea region context, but globally. In April 2023, inflation in Turkey reached 43.7%, having earlier peaked at 85.5% in October 2022. The currency crisis (the steep depreciation of the Turkish Lira), the Turkish government's expansionary fiscal policy in tandem with a loose monetary policy have contributed significantly to high inflation in Türkiye.
- Meanwhile, the two Black Sea countries involved in the ongoing war – Russia and Ukraine – have recorded rather different inflation dynamics. While **Ukraine** also records high inflation – standing at 17.9% in April 2023 - the corresponding indicator for **Russia** has dropped to as low as 2.3%. However, the low inflation rate in Russia should not be taken as a sign that the country is successfully dealing with the war and the sanctions imposed on it. On the contrary, the low inflation suggests that aggregate demand in the country remains low and consumers are being careful in their spending.
- Elsewhere, the war is cited as the main reason behind high inflation in the Black Sea region's two EU member states, namely **Bulgaria** and **Romania** which recorded YoY CPI inflation of 11.6% and 11.2% respectively in April 2023.
- At the same time, **Georgia** reported the lowest inflation in the Black Sea region during the first two months of 2023 (9.4% in January, and 8.1% in February), and this further declined to 1.5% in April 2023.

Monetary policy in Black Sea countries

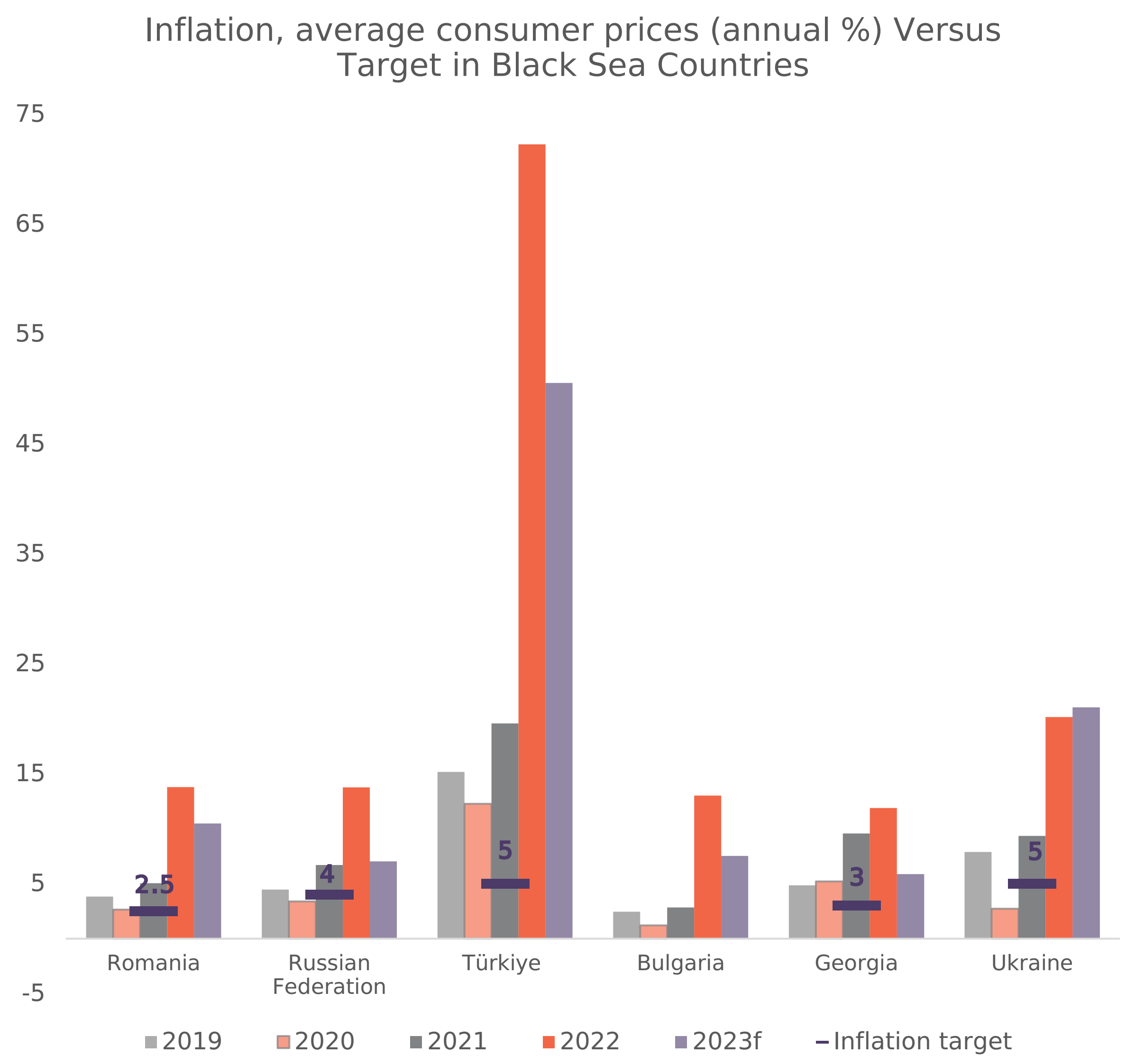
Monetary Policy Rate in Black Sea Countries



Source: National banks of Black Sea countries, May 2023

- The Black Sea countries also widely differ in their monetary policy approaches implemented to tackle high inflationary pressures. In **Türkiye**, the central bank, going against traditionally accepted economic theories, has put in place a loose monetary policy rate in response to high inflation and has kept interest rates low. Türkiye undertook a series of monetary policy rate cuts in 2022. In February 2023, its central bank again cut the monetary policy rate from 9% to 8.5%.
- Meanwhile, in **Ukraine**, the central bank, with the same inflation target as Türkiye, has maintained a much higher (about three times higher) monetary policy rate (25%). Despite fighting a war, inflation in Ukraine has been lower than in Türkiye and the former has managed to maintain relatively stable prices. Crucially, the inflationary pressures of the war in Ukraine have been kept down by state support programs and policies such as freezing tariffs for the population and fixing the Ukrainian Hryvnia exchange rate. Notably, those state policies have been implemented with the strong support of international partners (partner countries, international organizations, donors).
- **Russia**'s central bank (CBR) has also actively used monetary policy rate as a tool to stabilize inflationary pressures stemming from the war and related sanctions. Other factors, such as low aggregate demand, recovery in imports and Russian Ruble appreciation, have contributed to CBR's efforts for stabilizing inflation in the country.

Monetary policy in Black Sea countries



Source: IMF, World Economic Outlook Database, April 2023

- **Bulgaria** and **Romania**, both EU member states aspiring to join the euro area, have followed diverging monetary policy paths since their EU accession. Of note, Bulgaria has given up its monetary autonomy by anchoring its currency to the euro. As a result, its central bank has been limited in its usage of monetary policy tools to stabilize inflation, which has surged in the country since the beginning of the war. Meanwhile, Romania has gradually increased its monetary policy rate in response to rising inflation since February 2022. As a result, after the beginning of the war, inflation in Bulgaria was initially higher compared to Romania, though by March 2023, the pair had recorded almost the same inflation rate (14.0% and 14.5% respectively).

- Elsewhere, the National Bank of **Georgia**, with the second-highest monetary policy rate in the Black Sea region, actively utilizes a tight monetary policy rate to stabilize inflation in the country. Georgia has the highest monetary policy rate in the Black Sea region after Ukraine. From March 2022 onward, the National Bank of Georgia (NBG) had kept its policy rate at 11% but on 10 May 2023, the Monetary Policy Committee of the NBG announced the decision to reduce the monetary policy rate by 0.5 pp to 10.5%.

Conclusion and recommendations

- To sum up, inflation trends vary among Black Sea countries. Though overall, inflation in Black Sea countries, following a global trend, dropped during the first quarter of 2023.
- The Black Sea countries widely differ in their monetary policy approaches implemented to tackle high inflationary pressures. Though so far, regardless of which policy approach has been applied, inflation remains well above the targets set for all countries of the region, albeit some have enjoyed greater success in stabilizing inflation than others.
- From the analysis of the policy approaches of Black Sea countries, it would seem prudent to suggest that central banks should **apply or maintain a tight monetary policy as a means of stabilizing inflation.**
- At the same time, while tightening monetary policy, policymakers should **keep a focus on maintaining financial stability**. The recent failures of the regional banks in the US revealed that some banks were not sufficiently prepared to bear the stress of higher interest rates. Accordingly, while focusing on the goal of stabilizing inflation, central banks should also consider financial stability risks that might be implied. To maintain trust in the financial markets, policymakers can utilize tools such as imposing capital and liquidity requirements, risk monitoring, and prudential rules.
- As, currently, financial systems face substantial uncertainty, it is also important that policymakers remain **flexible and independent, and able to adjust policies to rapidly changing demands.** Accordingly, it is important for central banks to stay independent and be capable of employing tools to both stabilize inflation and maintain financial stability. Additionally, policymakers should closely follow fiscal policy developments and try to employ complementary policies, or at least keep fiscal policies in mind while designing monetary policies.
- Finally, it is crucial that central banks **clearly communicate their objectives and policy functions.** Indeed, maintaining confidence in central banks and policymakers is essential to maintain monetary and financial stability.

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Giorgi Khishtovani
Research Director
g.khishtovani@pmcginternational.com

Nika Kapanadze
Researcher
n.kapanadze@pmcginternational.com

Anastasia Chkhenkeli
Junior Researcher
a.chkhenkeli@pmcginternational.com

Address: 61 Aghmashenebeli Avenue, 3rd floor,
Tbilisi 0102, Georgia.
Tel: (+995 32) 2921171, 2921181
Email: research@pmcginternational.com
Website: pmcresearch.org