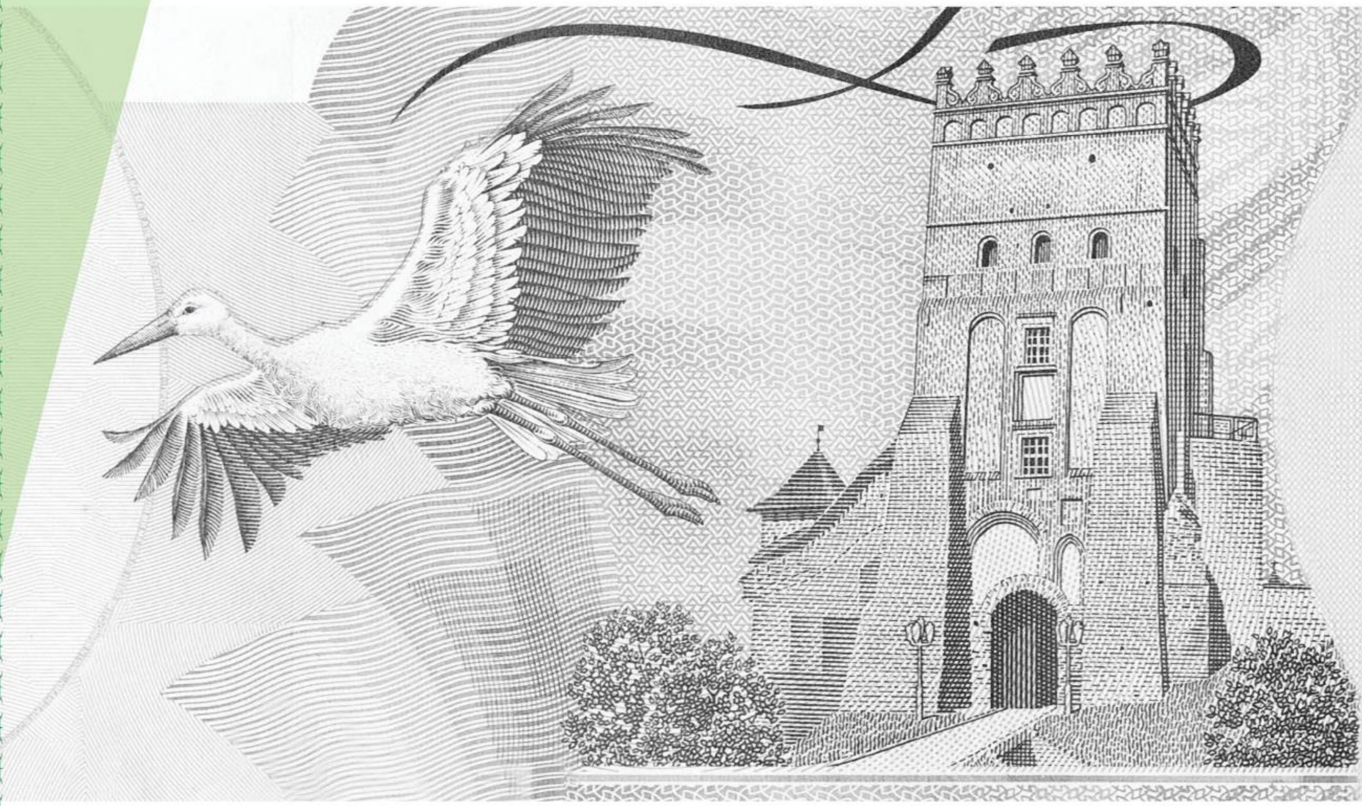
National Bank of Ukraine

Macroeconomic and Monetary Review

July 2020



Summary

External Environment

The situation on global commodity and financial markets improved in July as more quarantine restrictions were lifted in a number of countries, although risks of a further spread of the COVID-19 infection persisted. Global crude oil prices fluctuated just above USD 40 per barrel. The prices of steel kept being supported by sizeable demand from China and high iron ore prices driven by relatively limited supply. The prices of grains, especially wheat and barley, hovered within a rather narrow range as the new harvest started to come to the market and old inventories were depleted. Global financial markets saw a rise in investor interest in risky assets, particularly in emerging markets (EMs), while domestic currencies of the majority of EMs strengthened against the US dollar.

Inflation

In June 2020, consumer inflation increased to 2.4% yoy (from 1.7% in May), but was below the 5% ± 1 pp target range. The growth in raw food prices accelerated, particularly prices for animal farming products on the back of limited supply and fruit prices due to unfavorable weather. Also, fuel prices declined more slowly as global crude oil prices rose and business activity picked up. In contrast, core inflation did not change compared to May and stood at 3.0%. It continued to be restrained by weak domestic demand and pass-through effects from the hryvnia appreciation in previous periods.

In June 2020, the upward trend of export prices and higher energy prices made the decline in producer prices slow (to 4.6% yoy, from 5.1% yoy in May).

Economic Activity

In June, the Index of Key Sectors Output (IKSO) fell deeper to 9.6% yoy (8.9% yoy in May). The main negative contribution came from the drop in agricultural production (down by 40.6% yoy), especially in crop farming due to the late start of the harvesting campaign and lower yields of early grain crops. On the other hand, further easing of quarantine restrictions and a gradual recovery in domestic and foreign demand slowed the decline in industrial production (5.6% yoy) and resumed growth in wholesale and retail trade. Larger volumes of natural gas transit led to a slower decline in cargo transportation. Budget expenditures on road construction fostered an improvement in performance of the construction sector. However, passenger transportation, despite better transportation figures, continued to decline at a significant pace as some restrictions remain in force under the adaptive quarantine.

Labor Market

A recovery in economic activity on the back of the further easing of quarantine restrictions has supported the labor market, although labor demand still remained weak. Wage growth accelerated (to 7.4% yoy in nominal terms and 4.8% yoy in real terms), particularly in healthcare. Social benefits and higher pensions also propped up household income.

Fiscal Sector

In June 2020, the state budget ran a sizeable surplus of UAH 29.9 billion. This was driven by a rapid growth in revenues (by more than 63% yoy) boosted by large dividends received from state-owned companies. In contrast, tax revenues remained subdued due to still sluggish economic activity and weak domestic demand. State budget expenditures grew more rapidly (11.8% yoy), fueled by spending on social security, healthcare, and some other items. Local budgets posted a deficit (UAH 1.4 billion), which was typical in June. However, the large surplus of the state budget resulted in a positive balance of the consolidated budget.

Balance of Payments

The release of pent up demand led to a slower decline in imports of goods, primarily consumer goods. Export performance improved as well, including for the iron ores and metallurgical products amid a gradual recovery in foreign demand. As a result, the goods trade deficit widened compared to the previous months (to USD 0.8 billion), albeit remaining lower than last year. Considering a large surplus in the trade in services due to halted travel services, the current account posted a surplus in both June and H1: USD 0.8 billion and USD 6.7 billion respectively.

Unlike in previous periods, the financial account recorded capital inflows in June (USD 0.2 billion), which came from the public sector. The macrofinancial assistance received from the EU notably exceeded the decline in nonresident holdings of hryvnia domestic government debt securities. Moreover, outflows of private sector capital continued to decrease as cash outside banks grew more moderately and as the banking sector received long-term financing. The overall balance of payments surplus (USD 1 billion) and the disbursed IMF tranche lifted the international reserves to USD 28.5 billion as of end-June, covering 4.9 months of future imports.

Monetary Conditions and Financial Markets

In July, the NBU Board decided to keep its key policy rate unchanged, at 6% per annum. The current level of the key policy rate leaves room for the NBU to continue the monetary easing in case economic growth recovers slower than expected. At the same time, it will restrain prices from growing fast as business activity picks up.

Throughout most of July, the UONIA, the new indicator of interest rates in the interbank lending market, hovered in a narrow range just above the lower bound of the NBU's interest rate corridor. At the same time, yields on hryvnia domestic government debt securities on the secondary market edged up and the FX market turbulence increased due to psychological factors. The NBU intervened in the FX market to smooth out excessive exchange rate fluctuations without interfering with market trends. In July, the NBU was a net seller of foreign currency, selling a total of USD 0.4 billion.

The Macroeconomic and Monetary Review is a translation of the original report in Ukrainian. If there are any discrepancies between the original document and its English translation, readers should consider the Ukrainian version of the report as correct.