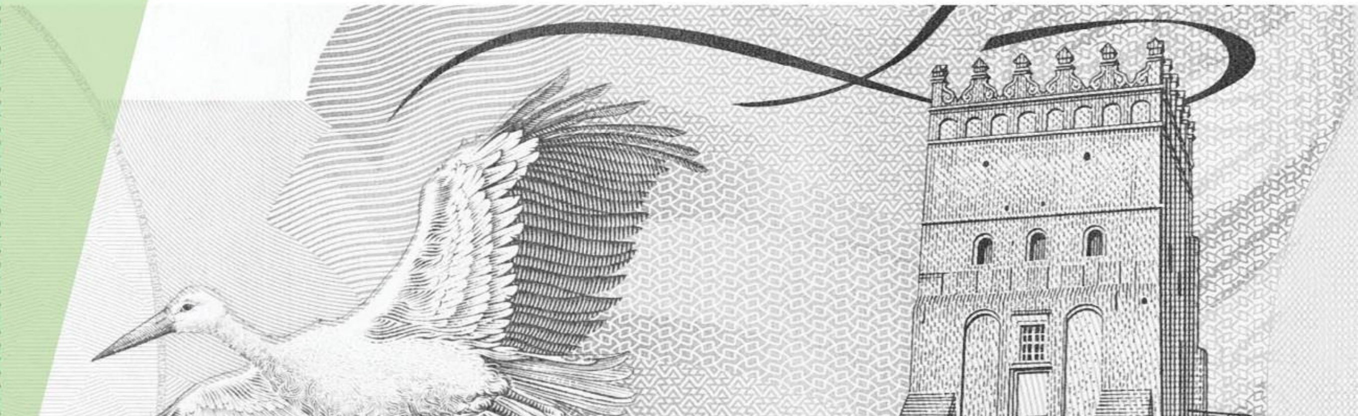
National Bank of Ukraine

Macroeconomic and Monetary Review

August 2020



Summary

External Environment

As the global economy gradually revived, demand in the global commodity markets expanded, driving up the prices of Ukraine's main export goods. Large-scale construction projects in China and a revival in the construction sector led to growth in the price of steel, and thus iron ore. Wheat prices fluctuated, driven by opposing forces: China and Egypt stepping up purchases and deliveries of newly harvested wheat in the market. Corn prices rose after a heat wave in Europe and a hurricane in the United States depressed corn yield expectations. Energy prices, including for oil and natural gas, also increased. The ample though somewhat diminished reserves in oil and natural gas storages were the only factor holding back price growth. As economic activity gradually recovered, most EM currencies strengthened against the U.S. dollar, except for those weakened by country-specific problems (such as Belarus's political turmoil, Turkey's declining FX reserves amid strong demand and capital outflows, and Brazil's political and social unrest).

Inflation

In July 2020, consumer inflation was flat from the previous month, at 2.4% yoy. As expected, it remained below the 5% ± 1 pp target range. Specifically, the growth in food prices decelerated, thanks to the new harvest, an increase in the supply of goods produced in small towns as public transportation reopened, and a rise in imports in recent months. In the meantime, the deep fall in fuel prices has been waning in annual terms with the rises in global crude oil prices and pickup in business activity. Core inflation, which came in at 3.0% yoy, was also unchanged from June.

The fall in producer prices deepened in July 2020 (to 7.4% yoy from 4.6% yoy in June), primarily driven by a decline in electricity prices as the share of nuclear power in the generation mix increased. In other sectors, however, price falls are slowing amid higher global energy prices-and a rise in export prices in some sectors.

Economic Activity

In July, the fall in the IKSO slowed to 5.3% yoy. The robust recovery of consumer demand amid growing household incomes and improving consumer sentiment sped up the growth in retail trade (to 8.5% yoy). Additional support for retail trade and the food industry came from the shift to domestic tourism as restrictions on foreign travel remained in place. In contrast, investment demand remained weak, holding back the production of investment goods, including machinery. Overall, however, the decline in industry slowed (to 4.2% yoy) thanks to an improvement in mining and energy. After getting off to a slow start, the harvesting campaign caught up, which, coupled with higher early grain yields (compared to when the campaign was launched), slowed the decline in agriculture (to 5.8% yoy). Construction volumes edged lower (by 1.1% yoy) as the decline in housing construction continued to deepen.

Labor Market

In July, wage growth accelerated (to 7.6% yoy in nominal terms and 5.1% yoy in real terms) as economic activity resumed. Demand for labor continued to recover, but remained below pre-quarantine levels. While interest in job search increased, the number of resumes declined, probably due to seasonal employment. Household incomes were also supported by higher pensions and social benefits.

Fiscal Sector

In July 2020, the state budget ran a significant deficit of UAH 32.4 billion. Revenues declined due to still subdued economic activity, as well as the comparison base effect (in July 2019, Naftogaz NJSC transferred the last installment of part of its net profit to the state budget, while this year it transferred the entire dividend in June). State budget expenditure continued to grow (by 27.8% yoy), fueled by spending on social security, healthcare, and road infrastructure. Local budgets in July as is traditional recorded a surplus (UAH 3.7 billion), but because of the large state budget deficit, the consolidated budget recorded a deficit as well.

Balance of Payments

In July, the current account surplus narrowed (to USD 360 million) as the deficit in the trade in goods continued to widen. Delayed harvesting and lower yields of wheat and oilseeds deepened the decline in exports of goods (to 15.9% yoy). In addition, an increase in shipments from Brazil led to a reduction in iron ore supplies from Ukraine to China. The drop in imports of goods also deepened slightly (to 21.6% yoy). Against the backdrop of fading pent-up demand, imports of industrial goods decreased, while the growth in imports of foods and household appliances decelerated. Energy imports also continued to fall amid high reserve stocks of natural gas. The surplus in the trade in services narrowed somewhat due to a slight recovery in foreign tourism, but remained high.

The financial account went back to recording capital outflows (USD 449 million), which were driven by the banking sector. The latter increased its assets by making FX purchases (including forward operations) and as a result of government's redemption of foreign-currency denominated domestic debt securities. Meanwhile, the government sector generated capital inflows after the government’s placement of Eurobonds offset external debt repayments and a further moderate decline in nonresident holdings of domestic government debt securities. As a result, the consolidated balance of payments ran a small deficit (USD 88 million). At the same time, a revaluation of financial instruments increased international reserves to USD 28.8 billion, a level that covers 4.9 months of future imports.

Monetary Conditions and Financial Markets

In August, interest rates on hryvnia loans and deposits continued to decline across the economy, responding to previous key policy rate cuts and the banking system’s growing liquidity. Throughout most of the month, the UONIA, the indicator of interest rates in the interbank lending market, hovered around the lower bound of the NBU’s interest rate corridor. The yields on hryvnia domestic government debt securities fell in both the primary and secondary markets. Hryvnia rates for bank customers also declined in July, reacting to the overall downtrend in market interest rates. At the same time, deposit inflows into banks continued, while outstanding hryvnia loans grew slightly from June as economic activity gradually recovered and the NBU imposed measures to stimulate bank lending (for details, see the July 2020 Inflation Report, page 31).

In the FX market, after weakening somewhat in the second half of July and early August, the hryvnia gradually strengthened, but on average it was slightly weaker compared to July. The NBU made FX interventions in the interbank FX market to replenish international reserves, generating USD 0.5 billion in net FX purchases in August (USD 1.2 billion year-to-date).

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.