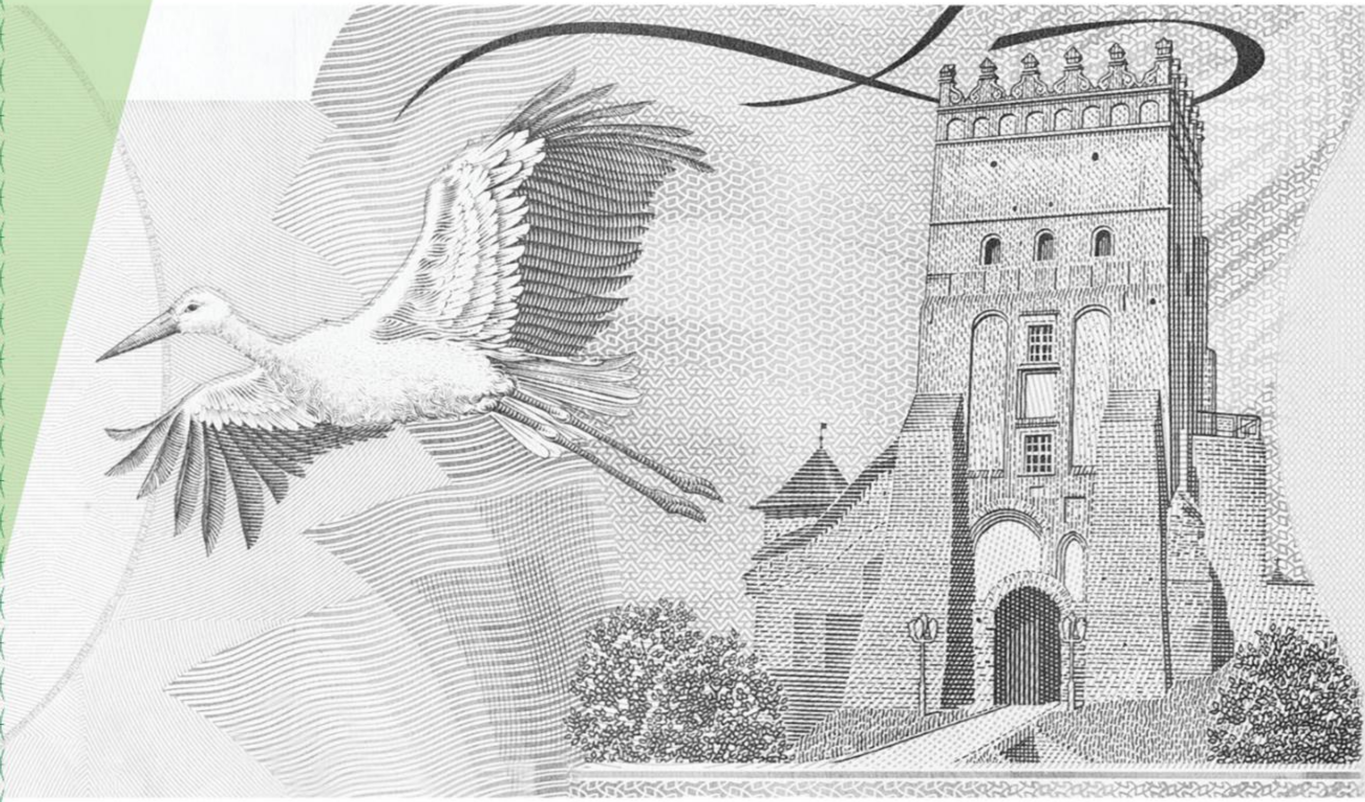
National Bank of Ukraine

Macroeconomic and Monetary Review

January 2021



Summary

External Environment

Since the beginning of 2021, the external environment has continued to improve, primarily due to further recovery in industry. Given the supply constraints, this kept global commodity prices relatively high. Oil prices rose as global supply expectations deteriorated amid announcements of crude production cuts by Saudi Arabia and Iraq, and of export reduction by Iran. Natural gas prices remained high due to severe frosts in the northern hemisphere and parts of China. Against the backdrop of a seasonal decline in demand in the weeks leading up to Lunar New Year's Eve, cold weather led to a downward correction in steel prices. Meanwhile, iron ore prices reached a ten-year high. This was due to supply disruptions from Australia, where the wet season started, and Brazil, after a fire broke out at the Vale iron ore terminal. Grain prices remained high due to the expected imposition of export tariffs by some countries amid sustained demand. In global financial markets, investors continued to take significant interest in risky assets, particularly those of EMs, thanks to expectations of new fiscal stimulus in the U.S. amid loose monetary conditions. As a result, most EM currencies appreciated against the U.S. dollar.

Inflation

In December 2020, consumer inflation accelerated to 5.0% yoy, reaching the midpoint of the 5% ± 1 pp target range. Core inflation accelerated to 4.5% yoy. Inflationary pressures were generated by the faster-than-expected recovery in the global economy, a further strengthening of domestic consumer demand, and higher prices for energy and certain foods. In particular, food prices rose faster due to poorer harvests of some crops, reduced production, and higher production costs. Natural gas prices grew at a faster pace, as the effects of the previous year's comparison base faded. The growth in prices for most nonfood products and services sped up, spurred by a weaker hryvnia, pressure from production costs, and strong consumer demand. At the same time, clothing and footwear prices fell more rapidly amid changes in consumer behavior and retail pricing policies, and lower global prices for fabrics due to weaker demand.

Producer prices continued to surge in December (14.5% yoy). This was primarily due to higher prices for Ukrainian exports (chemicals, metallurgy products, edible oils and fats), as well as rising prices for energy and electricity.

Economic Activity

The increase in the IKSO accelerated (to 9% yoy) in December as most sectors improved their performance. The growth in agriculture sped up sharply (to 26.0% yoy) due to a shift in the harvesting schedule for late winter crops and industrial crops. Retail sales increased more quickly (13.4% yoy), driven by the pent-up demand that accumulated during the "weekend quarantine", the anticipation of the January lockdown and faster wage growth. Industry returned to growth (4.8% yoy), which was fueled by robust external demand, rising budget expenditures, and colder-than-last-year weather. Much faster growth in budget expenditures on road infrastructure underpinned the growth in construction. Meanwhile, the recovery in industry and construction, and the growth in exports spurred wholesale trade and freight turnover.

Labor Market

In December, the growth in nominal and real wages accelerated (to 15.6% yoy and 10.1% yoy, respectively), driven in particular by the rebound in economic activity after the "weekend" quarantine ended. Meantime, labor supply and demand weakened because of seasonal effects and the anticipation of the January lockdown.

Fiscal Sector

The state budget ran a significant deficit of UAH 97.1 billion in December after expenditures caught up for almost all budget items. However, the state budget deficit in 2020 came out significantly lower than planned. This is due to the increase in revenues in recent months, primarily tax receipts. More specifically, revenue growth accelerated (to 33.1% yoy) in December due to high growth in domestic trade and wages, a rebound in imports, better administration of certain taxes, and a one-off tax receipt from a debt settlement between

Naftogaz NJSC, Ukrnafta PJSC, and the government. Local budgets also recorded a sizable deficit in December (UAH 32 billion). The result was a significant deficit in the consolidated state budget.

Balance of Payments

In December, the current account surplus narrowed to near zero (USD 0.1 billion) due to a recovery in imports growth and higher dividend payments. The growth in merchandise exports accelerated (to 18.2% yoy), driven by high global prices and increasing shipments of ferrous metals and iron ores. However, this growth was restrained by a lower supply of foods due to a poorer harvest this year. In addition, after a prolonged decline, merchandise imports returned to growth (1.4% yoy) in December, although natural gas and coal purchases fell from a year ago while prices for oil and petroleum products continued to be below the previous year's levels. Specifically, as domestic demand recovered, purchases of new and used cars, agricultural machinery, and some industrial and medical equipment increased.

Financial account inflows hit an eight-year high (USD 2.7 billion). With optimism pervading the global financial markets, the Ukrainian government made significant borrowings: it additionally issued long-term Eurobonds, received macrofinancial assistance from the EU and a loan from the IBRD, and cooperated with private creditors. At the same time, nonresidents took renewed interest in hryvnia domestic government debt securities, increasing their government securities portfolio by about USD 350 million. Coupled with a current account surplus, this ensured that the consolidated balance of payments recorded a significant surplus (USD 2.8 billion). As a result, international reserves came in at an eight-year high of USD 29.1 billion, enough to cover 4.8 months of future imports.

Monetary Conditions and Financial Markets

In January, the NBU left its key policy rate unchanged, at 6% per annum. In real terms, the key policy rate is being kept below its neutral level, meaning that monetary policy is accommodative. The January decision took into account that the factors behind the current acceleration in inflation are mostly temporary. At the same time, the economy was in need of support after a period of tightened quarantine restrictions.

The UONIA, the reference rate for borrowing in the interbank market, hovered around the lower bound of the NBU's interest rate corridor throughout January. Strong demand for hryvnia domestic government debt securities amid decisions to limit the supply of short-term securities helped reduce yields at the short end of the yield curve and improve the term structure of borrowings. As the latter increased, however, the weighted average yield on hryvnia domestic government debt securities also increased slightly. The banks continued to reduce hryvnia rates for their customers in December.

In January, supply and demand in the FX market were almost balanced. As a result, the average official hryvnia exchange rate against the dollar was little changed over the course of the month, with net FX purchases close to zero.

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.