Macroeconomic and Monetary Review

NATIONAL BANK OF UKRAINE

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Monetary Policy and Economic Analysis Department

Summary

● The price environment in global commodity markets remained broadly favorable since early February, despite diverse trends in steel price movements across regional markets, as prices for iron ores and grains kept rising. Global oil prices continued to trade in the range of USD 53 to USD 56 per barrel. Emerging market assets have regained appeal for investors. This, along with more benign global commodity prices, caused currencies of most EM countries to strengthen.

● As expected, headline inflation slightly accelerated to 12.6% yoy in January 2017. Core inflation was running at 6.2% yoy in January. A slight acceleration of annual inflation in January was expected, driven by increased production costs, rising global commodity prices (including oil and food), and the weakening of the hryvnia late in 2016 and in the first half of January 2017. Recent price trends in global commodity markets also remained the major driver of domestic producer inflation. In January 2017, producer prices accelerated to 36.8% yoy.

● Economic activity continued to recover at a relatively rapid pace. In January, growth of the Index of Key Sectors Output (IKSO) slowed down to 7.8% yoy as the positive effect of a bountiful harvest waned. Since the beginning of the year the agricultural production index traditionally reflected only the performance in the animal breeding sector, which continued falling (by 2.4% yoy). In addition, the growth of retailers' trade turnover slowed in January, weighed down by worsening consumer confidence. Meanwhile, the remaining economic sectors showed a marked recovery, including construction and freight turnover, albeit a low comparison base contributed strongly to the acceleration (in January last year, trade and transit restrictions were launched by Russia and some sectors' performance was hit by adverse weather conditions). Demand in the construction industry underpinned production of a wide range of construction materials, while benign prices for steel products supported metallurgical production. Overall industrial output growth accelerated to 5.6% yoy.

● Labor demand recovered after a decline late last year. The growth of average wages accelerated significantly both in nominal and real terms (to 37.7% yoy and 21.4% yoy respectively), primarily due to the increase in the minimum wage.

● The consolidated budget surplus reached UAH 25 billion due to fiscal surpluses at all levels of government. Thus, despite high expenditure growth, the state budget reported a significant surplus of UAH 15.8 billion. This surplus was attributable to exceptionally high tax revenues, with VAT proceeds accounting for nearly 2/3 of the total. The robust growth in tax revenues was underpinned by both general economic factors and tax changes. A low volume of VAT refunds was another important factor, although a temporary one. Local budgets also showed a sizable surplus of UAH 9.3 billion, a typical performance for this month.

● The current account deficit narrowed to just USD 26 million owing to a lower trade deficit. Export growth accelerated significantly due to increasing foods exports, while import growth decelerated marginally. The financial account recorded net outflows of USD 177 million, including USD 133 million from the private sector, primarily due to repayments of interbank loans (USD 302 million). There were marginal FDI inflows of USD 17 million, while cash outside banks continued to decrease (USD 149 million). Due to an overall balance of payments deficit (USD 202 million), gross international reserves declined to USD 15.4 billion or 3.4 month of future imports.

● Market interest rates continued to decline gradually, although the key policy rate has remained unchanged since the end of October 2016. Market interest rate dynamics reflected the delayed effect of aggressive easing of monetary policy in prior periods and the expansion of surplus liquidity in the banking sector. In the face of declining economic activity, the bank lending remained subdued, although hryvnia loans to households grew marginally. Typically for the beginning of the year, the stock of bank deposits decreased. Meanwhile, the situation in the FX currency market in February remained largely stable.

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