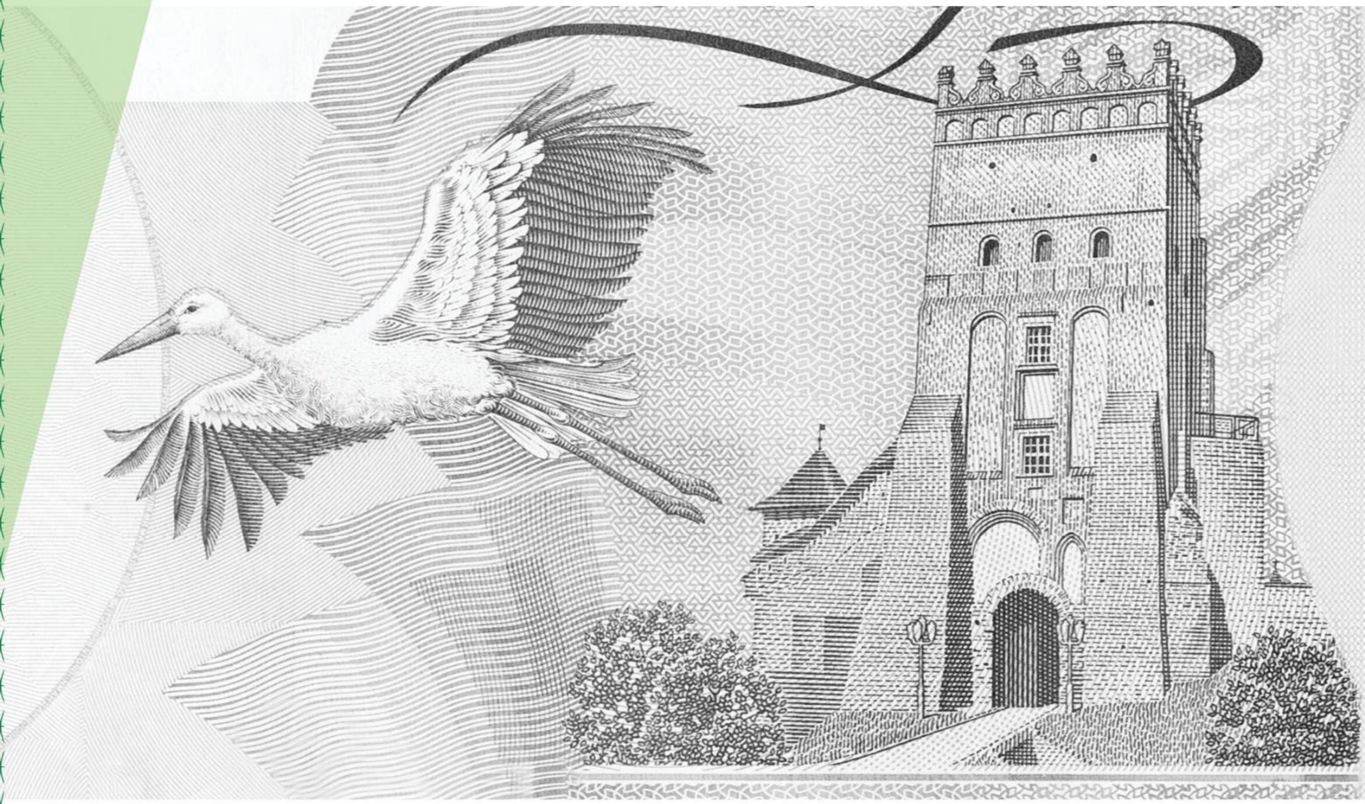
National Bank of Ukraine

# Macroeconomic and Monetary Review

## May 2018



## Summary

● **In May 2018, Ukrainian exporters saw a more benign external price environment.** Although steel prices were down in most regional markets, export prices for Ukrainian steel products rose on steady demand from European countries. Grain prices grew as well, driven by a seasonal decrease in stocks, drought in several countries and also by solid demand. Meanwhile, the attention of commodity market players was focused on the oil market. Global oil prices surged to a four-year high of USD 80 per barrel, driven by heightened geopolitical pressures and a high level of compliance to the OPEC+ agreement.

● **Emerging markets continued to face a worsening global financial environment**, as investors anticipated a faster pace of monetary policy tightening by the Federal Reserve, and also due to rising protectionism globally and renewed strengthening of the US dollar. This affected capital flows to Ukraine as well, although relatively moderately. Thus, the public sector's net external liabilities decreased as foreign investors' appetite for hryvnia-denominated bonds weakened in April 2018. However, net capital inflows to the real sector helped maintain net financial account inflows (USD 119 million).

● The current account also reported a surplus. Aided by high global prices for Ukrainian exports and the favorable effect of the comparison base, exports grew rapidly (by 19.6% yoy in April). Although import growth also accelerated (to 18.1% yoy), boosted by strong domestic demand, exports grew faster than imports, causing the merchandise trade deficit to narrow in April compared to March. Together with lower external debt service payments, this resulted in the current account balance turning positive (UAH 175 million). As a result, **the overall balance of payments showed a surplus of USD 290 million. As a result, international reserves rose by 1.3% mom, to USD 18.4 billion as of the end of April, covering 3.3 months of future imports.**

● **The NBU's tight monetary policy stance** helped mitigate the adverse impact on Ukraine of tightening global financial conditions. Thus, at its recent monetary policy meeting, the NBU Board decided to leave the key policy rate unchanged at 17.0% pa. As before, interbank interest rates and government bond yields closely tracked the key policy rate. Other market interest rates also responded to changes in the key policy rate, although some of them continued to exhibt the lagging effects of past interest rate increases.

● **The effect of the tight monetary policy was mostly seen in the exchange rate channel**. Together with other factors (such as favorable global commodity prices), the tight monetary policy contributed to a further strengthening of the hryvnia against both the US dollar and the currencies of Ukraine's main trading partners. In turn, this helped contain imported inflation pressures, although the weakening of the hryvnia exchange rate in late 2017 – early 2018 fed through to prices for some imported non-food products (primarily, clothing and footwear) in April. Apart from this, food prices kept rising at a fast pace, driven by supply-side factors. In addition, a further rise in production costs, in particular, for labor, as well as rapidly recovering consumer demand continued to contribute to inflation pressures. As a result**, headline inflation slowed down moderately (to 13.1% yoy in April), while core inflation held steady compared to March, at 9.4% yoy.**

● **Continued strong momentum in retail trade and passenger turnover signaled buoyant consumer demand.** This was prompted by robust growth in nominal and real wages (27.3% yoy and 12.5% yoy, respectively) and improved consumer confidence. In addition, industrial production growth accelerated, primarily due to a favorable comparison base effect, as the impact of the disruption of trade with non-government controlled areas (NGCAs) was fully realized in April last year. This offset the continuing moderate contraction in agricultural production and a deeper decline in the construction sector, most notably in the housing sector. As a result, the Index of Key Sectors Output accelerated to 3.5% yoy.

● In April, the growth in tax and non-tax proceeds accelerated, which, however, largely reflected one-off effects. In the meantime, the increase in these revenues helped offset a substantial decline in other budget revnues (due to the transfer of confiscated funds in April 2017) and an increase in expenditures, primarily social spending. **As a result, in April 2018 the state budget deficit narrowed to almost zero. The consolidated budget posted a surplus of UAH 3 billion, owing to a positive local budget balance.**

*The Macroeconomic and Monetary Review is a translation of the original Report in Ukrainian. In case of any discrepancies between the original document and its English translation, readers should consider the Ukrainian version of the Report as correct.*