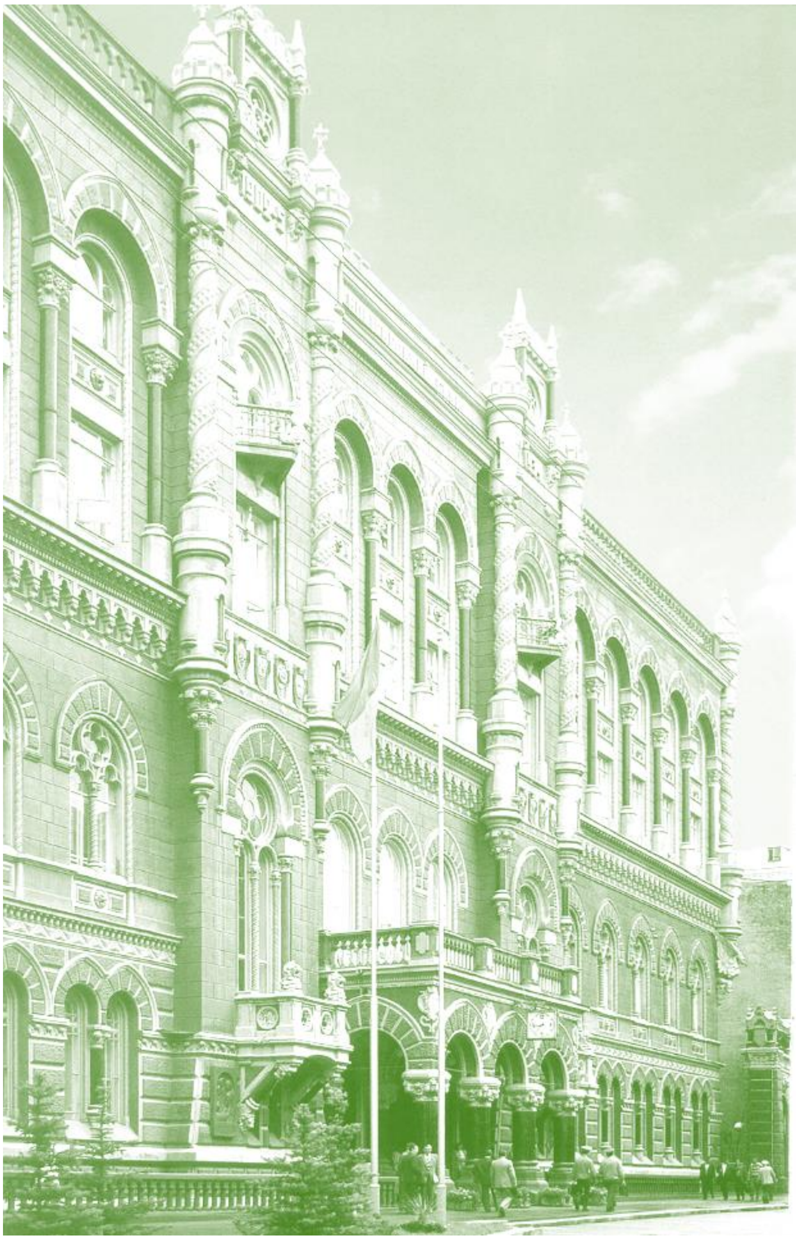
Macroeconomic and Monetary Review

NATIONAL BANK OF UKRAINE

June 2017



Monetary Policy and Economic Analysis Department

Summary

● In June 2017, global price conditions for commodities that prevail in Ukrainian exports, with the exception of iron ore, improved. Indeed, steel prices showed an upward trend due to stronger demand from the US and China, as well as the introduction of new anti-dumping duties by the European Commission and Egypt. However, iron ore prices continued to decline, driven by record supply. Grain prices grew throughout much of June; however, at the end of the month corn prices fell sharply as Brazil started to offer freshly harvested corn. Oil prices resumed their decline, due to ramping up production in the United States, Nigeria and Libya. At the end of the month, the Euro appreciated sharply against the US dollar as markets incorrectly interpreted M. Draghi's statements as a signal that asset purchase program is close to the end. Currencies of commodity-exporting EM countries in June depreciated to US dollar, while those of CEE countries strengthened.

● In May 2017, headline inflation in Ukraine accelerated to 13.5% yoy, as expected. Actual inflation, both in annual and monthly terms, was higher than projected by the NBU, primarily reflecting faster growth in raw food prices and a stronger impact of administered factors. Meanwhile, underlying inflation pressure was weaker than expected – core inflation remained almost stable (6.5% yoy), owing to the improvement in inflation expectations amid a further strengthening of the hryvnia against the US dollar. Producer price inflation driven mainly by global commodity price developments decelerated to 27.1% yoy.

● In May, the Index of Key Sectors Output grew by 4.1% yoy after a slight decline a month earlier. The growth was supported by improved consumer confidence and business expectations, as well as boosted by local budget capital expenditures. Therefore, domestic trade and construction were the main contributors to the IKSO growth. Industrial production also resumed growth (by 1.2% yoy). In May, the agricultural production index fell by 3%, due to a drop in animal breeding output (primarily poultry and pig breeding).

● In May 2017, labor demand continued to grow moderately. However, in March and April 2017, the decrease in the total number of employees deepened, mainly due to the seizure of enterprises in the NGCA and their subsequent exclusion from statistical observations. Average nominal and real wages grew rapidly (by 37.2% yoy and by 20.4% yoy respectively), reflecting a rise in the minimum wage at the beginning of the year. In May, the number of households receiving subsidies declined sharply. The decline reflected technical delays in the accrual of subsidies resulting from changes in the rules for granting subsidies.

● In May, for the second month in a row, the state budget recorded a surplus (UAH 7.0 billion). This was mainly the result of an increase in tax revenues, driven by significant proceeds from corporate income tax due to enterprises' better financial performance. The NBU's profit transfers were also an important factor. Local budgets recorded a surplus of UAH 4.9 billion, which narrowed slightly compared to April, due to increased expenditures, including capital investment. The consolidated budget surplus amounted to UAH 11.9 billion in May, tallying UAH 50.5 billion for the first five months of 2017.

● The current account deficit widened to USD 0.2 billion, due to a larger merchandise trade deficit. The growth of exports accelerated; however, imports grew even faster, driven mainly by a sharp increase in energy imports. Unlike in April, net financial account inflows (USD 0.6 billion) were primarily generated by the private sector. A further reduction in FX cash outside banks and rising trade credits were primarily responsible for the inflows. Moreover, in May, capital inflows were recorded due to the issue of corporate Eurobonds. Due to the overall BoP surplus (USD 0.4 billion) gross international reserves increased to USD 17.6 billion, or 3.7 months of future imports, by the end of May.

● At the end of May, the NBU Board reduced its key policy rate by 0.5 p. p. to 12.5% per annum. The decision was consistent with the meeting of inflation targets set for 2017-2018, and was aimed at promoting economic growth. Market rates for domestic currency resources continued to decrease in May. The situation on the FX market remained favorable in May, which, together with reasonably balanced inflationary risks, allowed the NBU to continue relaxing FX restrictions. Despite weak lending activity in general, consumer loans continued to increase in May.

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.