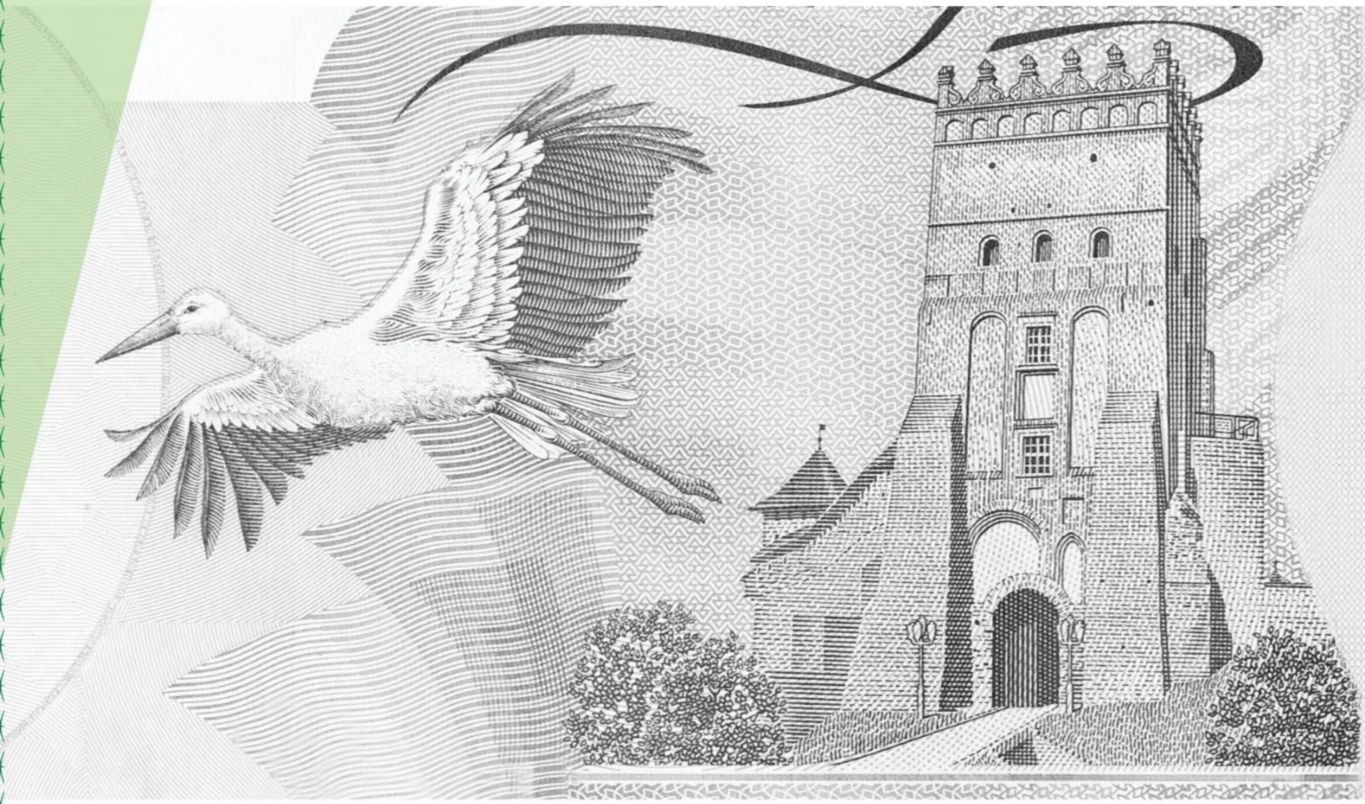
National Bank of Ukraine

Macroeconomic and Monetary Review

June 2018



Summary

● **In June, Ukrainian exporters faced worsened global price conditions due to lower steel prices, although these were only down moderately, and a drop in the price of some grains.** Steel prices were lower, weighed down by tariffs imposed by the United States and by rising output, while strong growth in both the advanced and emerging economies supported prices. Across prices for selected grains, corn prices dipped sharply on improved harvest expectations, while wheat prices were on the rise due to lower yields amid droughts in several countries. After peaking last month, oil prices adjusted downward and traded in a narrow range on the expectation that the upcoming OPEC+ meeting will result in agreement to raise production, but increased by the end of the month as trade wars intensified.

● **Emerging markets continued to face more challenging global financial conditions.** Alongside another Federal Reserve interest rate hike, the ECB's decision to wind down its QE program and deteriorating trade relations between the US, the EU and China affected risk sentiment. Emerging market currencies mostly depreciated on the back of a strengthening of the US dollar and continued monetary policy tightening by advanced countries.

● **Meanwhile, the Ukrainian currency held relatively steady in May after strengthening during the previous months.** Deteriorating external financial conditions caused a further reduction in non-resident holdings of hryvnia bonds in May, albeit a rather moderate one. Simultaneously, larger volumes of foreign-currency-denominated sovereign bonds were purchased by local banks, trade credits to the real sector increased, and FDI inflows remained steady. As a result, net financial account inflows increased to USD 0.3 billion, which, given a close to zero current account balance, contributed to the overall balance of payments surplus. However, international reserves had declined to USD 18.2 billion as of the end of May, or 3.2 months of future imports, due to the repayment of IMF loans.

● **The largely balanced current account compared to the April surplus resulted, in turn, from the widening deficit in the balance of merchandise trade.** In May, commodity exports rose, propelled by a favorable price environment. However, the pace of growth slowed (to 13.2% yoy) as the stocks of agricultural crops from last year's harvest were being drawn down and maintenance and repair works were launched by selected industrial enterprises (in particular, in the mining and metals industry). Driven by these factors, industrial output growth slowed, while freight turnover and wholesale trade declined. Instead, the continued growth in construction and strong momentum in retail trade and passenger turnover signaled steady consumer demand (among other factors, due to the acceleration of real wage growth to 14.1% yoy). However, they failed to offset the worsened performance of the remaining sectors. As a result, the Index of Key Sectors Output slowed its growth substantially (to 1.6% yoy). Moreover, robust domestic demand amid significantly higher fuel prices caused imports to rise further, although the pace of growth slowed as well against a less favorable base of comparison.

● **May 2018 saw a substantial slowdown in headline inflation - to 11.7% yoy.** This further deceleration in annual inflation was mainly the result of a sharp slowdown in food price inflation. Thus, the effects of the temporary supply factors that drove prices higher in H2 2017 and in early 2018 have been gradually fading, as anticipated. In addition, administered prices grew less rapidly than in April. Core inflation decelerated in May, to 9.3% yoy, due to a slower growth in the prices for food products and services. In the meantime, as in previous months, further rise in production costs, particularly labor costs, and a rapid recovery in consumer demand continued to pressure prices.

● **At its last monetary policy meeting the NBU Board decided to leave the key policy rate unchanged at 17.0% pa.** As before, market interest rates for hryvnia resources closely tracked the key policy rate. While the NBU's policy rate has been kept unchanged in recent months, minor variations in market interest rates reflected factors specific for selected segments of the market.

● **In May 2018, the state budget recorded a surplus of 11.4 billion, primarily due to higher revenues**. Meanwhile, expenditures continued to rise at a fast pace. Revenue performance has improved due to economic factors (improved financial performance of enterprises and rising household incomes, increased production of goods subject to excise tax, in particular, fuels). This was also due to temporary effects, such as a shift in the schedule of the NBU's profit transfers to the second quarter. Expenditures grew rapidly, primarily due to higher spending on external debt servicing. Local budgets showed a surplus of UAH 3.1 billion in May. The surpluses recorded by budgets at all levels produced an increase in the consolidated budget surplus to UAH 14.6 billion 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.