



NATIONAL
BANK OF
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Macroeconomic and Monetary Review

July 2017



Monetary Policy and Economic Analysis Department

Summary

- Global price conditions for commodities that prevail in Ukrainian exports improved in July 2017. Thus, steel and iron ore prices increased, primarily on the back of stronger demand from China. Grain prices were also predominantly rising due to adverse weather conditions across selected world regions. Oil was traded in a narrow price range – downward price pressure from output expansion, primarily in some OPEC countries, were offset by robust demand. The worsening investors' confidence over the US President's ability to fulfill campaign pledges and expectations about the weaker pace of the Fed monetary policy tightening caused US Dollar to weaken further against major currencies. Given this environment, most emerging market currencies have strengthened.
- Headline inflation expectedly accelerated, picking up to 15.6% yoy in June 2017. Actual inflation came in above the NBU's projections, primarily reflecting a faster-than-expected growth in raw food prices and the continuing strong impact of administered factors. Meanwhile, underlying inflation pressures remained moderate, broadly in line with the NBU expectations. Thus, core inflation slightly accelerated to 6.8% yoy in June. The producer price index continued to decelerate to 26.3% yoy mainly driven by global commodity price developments.
- In June, annual growth rate of the Index of Key Sectors Output (IKSO) accelerated slightly (to 4.3%). Most key economic sectors showed improved performance. Growth in the construction sector accelerated (to 32% yoy), signaling investment demand remained a strong boost to economic growth. Along with investments, consumer demand has gained momentum, as a high pace of growth in retail trade turnover was maintained (9.0% yoy). Industrial production has continued to recover from the shock caused by the disruption of trade ties with the non-government controlled area (NGCA) and the seizure of companies there, with growth accelerating to 3.8% yoy. The fall in the agricultural production index deepened to 4.6% yoy due to slower harvesting works and lower grain yields.
- Demand for labor remained virtually unchanged. The average nominal wages continued to grow rapidly (37.2% yoy), with growth supported by a pick-up in economic activity in the majority of sectors. As headline inflation accelerated, the growth of real wages slowed down (to 18.9% yoy).
- In June, the state budget, recorded a surplus (UAH 2.6 billion), a rather non-typical pattern for this month. The surplus was achieved due to a significant increase in revenues, although expenditure growth also sped up. Key sources contributing to the acceleration of revenue growth were dividends and lump-sum 2016 profit transferred by enterprises with state ownership, and the next transfer of NBU's profit for the previous year as well. Unlike the state budget, local budgets showed a slight deficit (UAH 0.9 billion) due to increased expenditures. However, the consolidated budget surplus was maintained.
- The current account recorded a deficit of USD 518 million, compared with a USD 88 million surplus in June last year. The negative balance was attributed to a widening merchandise trade deficit (in particular, due to significant volumes of energy imports) and to larger primary income deficit (due to higher amount of repatriated dividends). Net financial account inflows (USD 0.8 billion) were primarily generated by the private sector both owing to a further reduction in FX cash outside banks (USD 0.6 billion) and inflows of direct and portfolio investment. Due to the overall BoP surplus (USD 0.3 billion), gross international reserves increased to USD 18.0 billion as of the end of June, or 3.7 months of future imports.
- At its last monetary policy meeting the NBU Board decided to keep the key policy rate unchanged at 12.5% pa. This decision was aimed at containing the likely impact of faster growth in raw food prices on inflation expectations and mitigating demand-pull pressures stemming from expected increase in pension benefits in October this year. However, lagged effects of the NBU's monetary policy easing in April-May continued transmitting to market interest rates. The latter contributed to a rebound in lending. Hryvnia deposits kept flowing to the banking system.

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.