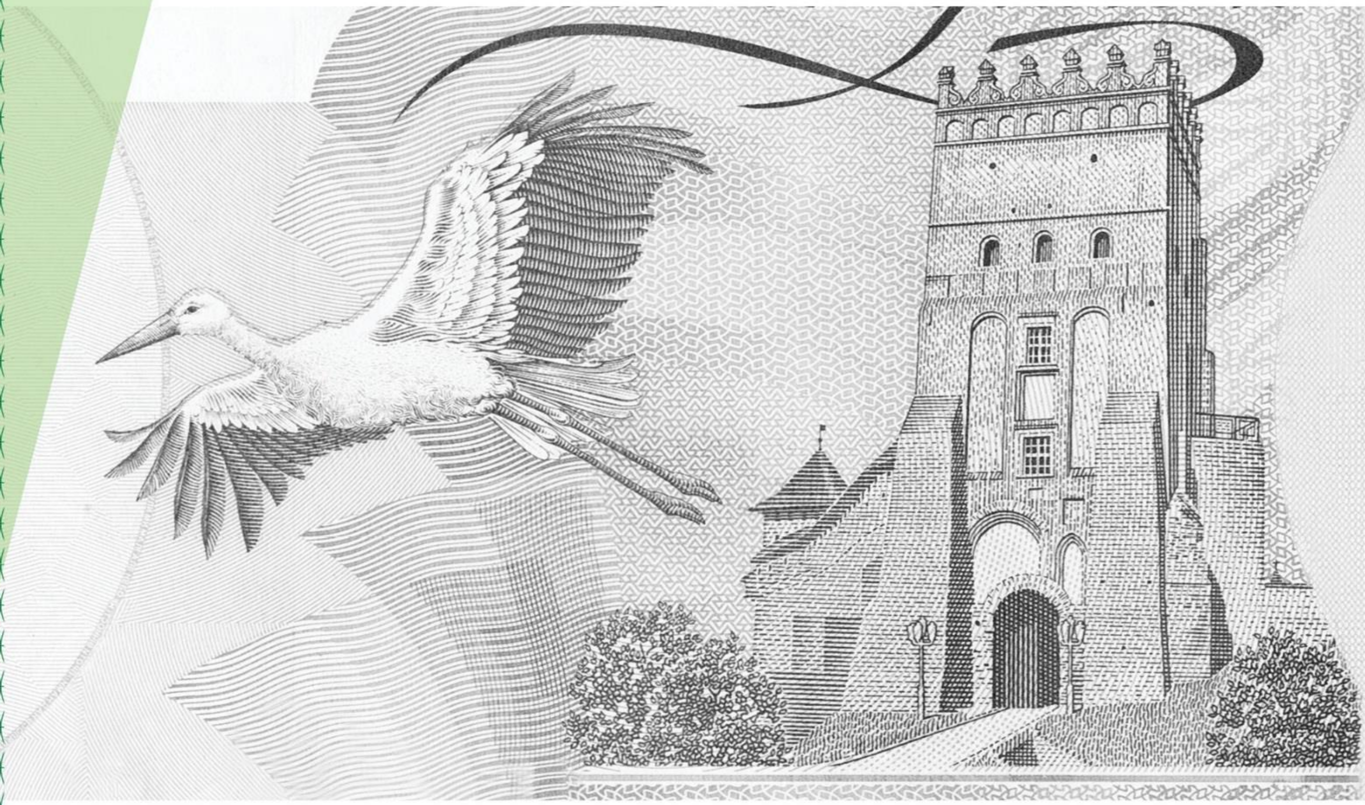
National Bank of Ukraine

Macroeconomic and Monetary Review

July 2018



SUMMARY

● **In July 2018, Ukrainian exporters faced a slightly worsened global price environment** due to declining prices for iron ore and selected grains. Wait-and-see business attitude including due to entrenched trade tensions between China and the United States and sluggish demand due to the rainy season in East Asia weighed on business activity on global steel markets. Global grain prices showed mixed trends: worsened yield outlook in several regions propelled wheat prices, while corn prices decreased on the back of higher U.S. exports. Oil prices were declining gradually, driven by more ample supply.

● **Emerging markets continued to face challenging global financial market conditions.** Meanwhile, in late July, emerging market stock indices benefitted from a lull in trade conflicts, which also helped their currencies to strengthen somewhat towards the end of the month.

● **Since mid-June, the hryvnia has come under downward pressure:** the official exchange rate of the hryvnia was virtually unchanged in June, while depreciating by 2.2% in July. The prices for prevailing Ukrainian export commodities, which were still much higher than last year, primarily for steel products, as well as a ramp-up in food exports had supported the hryvnia exchange rate. The non-resident flee from the hryvnia securities was also moderate so far. Simultaneously, the FDI inflows rose substantially in June (although the debt-to-equity operations accounted for the bulk of inflows) and import growth slowed substantially, most likely, due to a temporary effect as customs clearance of import supplies stalled after the government had approved a plan for combating smuggling. As a result, the overall balance of payments ran a small surplus of USD 23 million. However, international reserves declined to USD 18 billion as of the end of June, or 3.1 months of future imports, due to the repayments of the IMF loans.

● **Meanwhile, the hryvnia strenghtened against MTP currencies** on the back of their depreciation relative to US dollar, **contributing to disinflation** as the cost of imported goods and the prices of goods and services with a significant imported inputs grew at a slower pace. Along with a ample food supply on the back of more favorable weather this year and rising imports, this drove **a marked slowdown in consumer price inflation in June 2018, to 9.9% yoy**. Core inflation also decelerated in June, to 9.0% yoy. At the same time, the core inflation has remained elevated, reflecting the strong underlying inflation pressures. This was mainly the result of robust consumer demand, fueled by rapid real wage growth (13% yoy) and rising pension benefits.

● Given the sustained strong domestic demand, the weakening in investor appetite for emerging markets assets, a delay in the disbursement of the next tranche from the IMF and the still high inflation expectations, **at its last monetary policy meeting the NBU Board decided to hike its key policy rate to 17.5% per annum** (effective from 13 July 2018). A tighter monetary policy stance was necessitated by higher upside risks to bringing inflation back to the target range in 2019. Responding to the key policy rate hike in July, the hryvnia interbank loan interest rates and government bond yields have risen. Minor variations in commercial bank retail interest rates reflected factors specific for selected segments of the money market.

● **The IKSO growth accelerated in June and overall in the second quarter of 2018 (to 7.0% yoy and 4.3% yoy, respectively).** The early start of harvesting was among the key drivers of acceleration. Also, in the second quarter performance in the construction and transport sectors improved. However, the acceleration of industrial output was modest compared with the previous quarter, despite the favorable comparison base, while June saw a slowdown in industrial output compared with May. The latter was a result of the weakened performance in machine building, chemical industry and coke production, only partially offset by the recovery in metallurgy and the accelerating growth in the food processing. In addition, the second quarter saw a slight deterioration in domestic trade performance, particularly on account of wholesale trade. Despite a slight slowdown, retail trade growth remained fairly strong as an evidence of a sustained robust consumer demand.

● **In June 2018, the state budget recorded a minor deficit (UAH 0.6 billion), despite a rapid deceleration in revenue growth** (to 14.7% yoy). The latter was attributable to lower dividends paid by the Naftogaz PJSC from profit for 2017 and a slowdown in import growth. At the same time, expenditure growth also slowed sharply (to 19.8% yoy), in particular on domestic debt service spending and the social programs. In June, local budgets reported a deficit (UAH 3.6 billion) as well, mainly due to a slowdown in revenue growth. As a result, the consolidated budget showed a deficit (UAH 3.7 billion), however, the cumulative balance remained positive.

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.