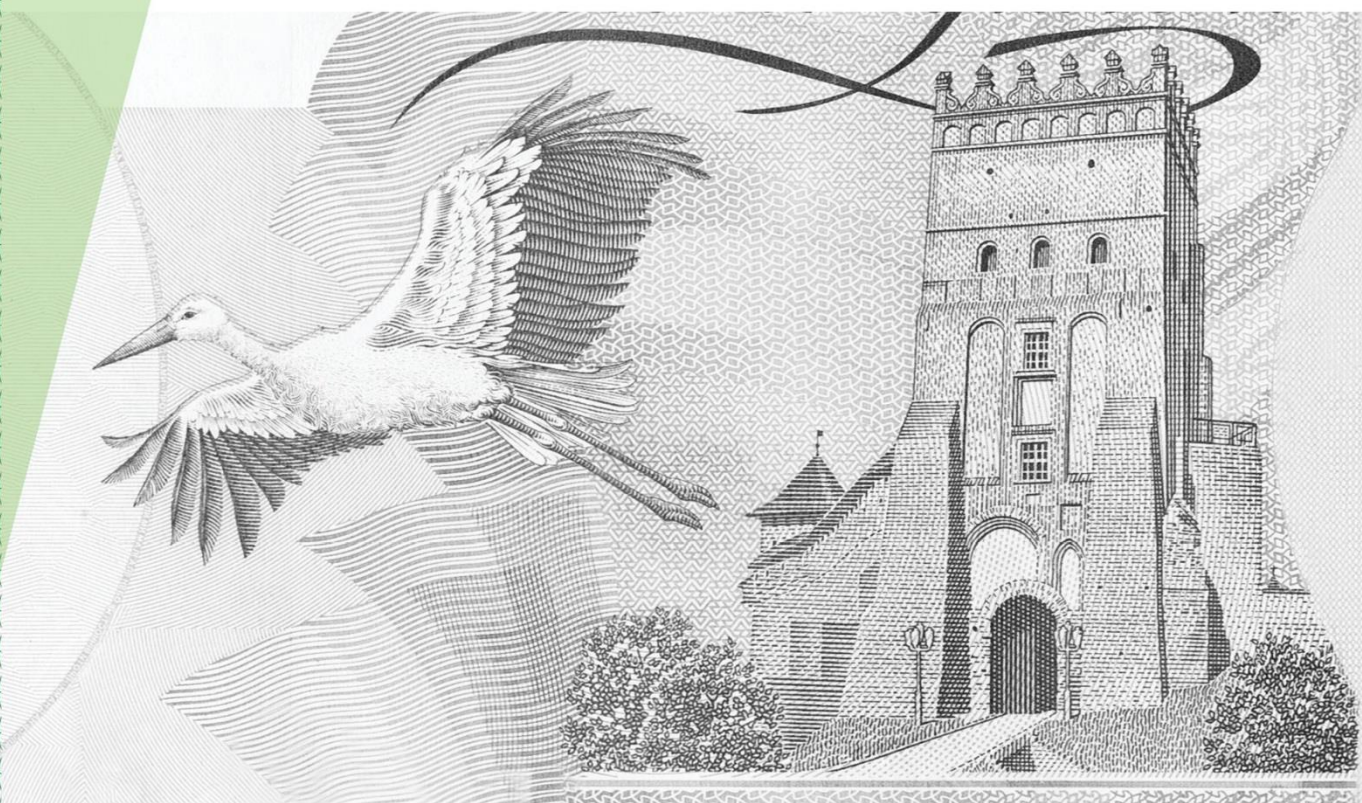




National Bank
of Ukraine

Macroeconomic and Monetary Review

August 2018



SUMMARY

- August 2018 saw heightened volatility in global financial markets sparked by the materialization of the currency crisis in Turkey and further escalation of the trade conflict between the U.S. and China. The investors' concerns about the contagion effects of Turkey's financial instability led to capital outflows from emerging market assets with their currencies mostly depreciating relative to the US Dollar.
- Meanwhile, Ukrainian exporters saw improved global price conditions on the back of higher monthly average prices for grains, especially wheat, with the latter rising due to the drought affecting the harvest volumes in several countries. In spite of this, Ukrainian foreign exchange markets experienced heightened turbulence due to external, seasonal and psychological factors. In particular, demand from energy importers rose amid higher global energy prices. Thus, following a drop in early August, oil prices picked up on expectations of a reduction in Iran's production due to U.S. sanctions.
- Apart from energy imports, growth in non-energy imports accelerated notably in July as well to a significant extent due to temporary factors. The latter played a noticeable role in modest improvement in export performance. As a result, the paces of growth in exports lagged behind those of imports (12.6% yoy and 24.9% yoy, respectively). This, along with larger volumes of repatriated dividends, caused a widening of the current account deficit (to USD 1.1 billion). At the same time, the overall balance of payments showed only a minor deficit (USD 0.2 billion) owing to net financial account inflows (USD 0.9 billion), as in previous months generated by the private sector. However, this caused a decline in international reserves to USD 17.7 billion at the end of July, or 3.0 months of future imports.
- Despite the weakening in the hryvnia exchange rate to the US Dollar, the trade-weighted exchange rate of the hryvnia relative to the basket of Ukraine's MTP's currencies changed only moderately. This helped restrain the growth in prices for non-foods. Along with an increase in food supply, this prompted a further slowdown in consumer price inflation in July, to 8.9% yoy. Core inflation also decelerated slightly, to 8.8% yoy, however, stayed at high levels amid sustained consumer demand, buoyed by strong growth in real wages (14.7% yoy in July compared to 13% yoy in June).
- Solid paces of increase in retail trade turnover and accelerated growth in construction indicated consumer and investment demand remained robust. In addition, industrial output grew faster, helped by a rebound in the mining industry and the accelerated growth of the metallurgy industry. However, the IKSO showed slower growth in January-July 2018 (3.1% yoy). This was mainly a result of a dip in crop production in July as the effect of the early harvesting campaign faded out while grain yields this year were lower than last year.
- In July, the state budget deficit widened (to UAH 3.6 billion), despite improved revenue performance. The latter reflected a faster growth in tax revenues, driven by a combination of economic factors (the acceleration in imports, the hryvnia weakening relative to the US dollar, growth in production of selected excisable goods). At the same time, the expenditure growth accelerated as well, largely driven by spending on the purchase of goods and services and on social care. In July, local budgets returned to surplus (UAH 0.6 billion); however, the consolidated budget showed a deficit (UAH 2.9 billion). On a cumulative basis, a moderately positive balance was maintained.
- The key policy rate stayed high in real terms in July-August, inter alia, as a result of the NBU Board's nominal key policy rate hike by 50 pp to 17.5% per annum effective from 13 July 2018. The hryvnia government bonds yields and interest rates on interbank loans broadly followed the key policy rate pattern. Interbank market rates rose in late August due to the narrowing of liquidity in the banking system. Commercial bank retail interest rates barely changed in July, with minor movements reflecting sector specific factors.