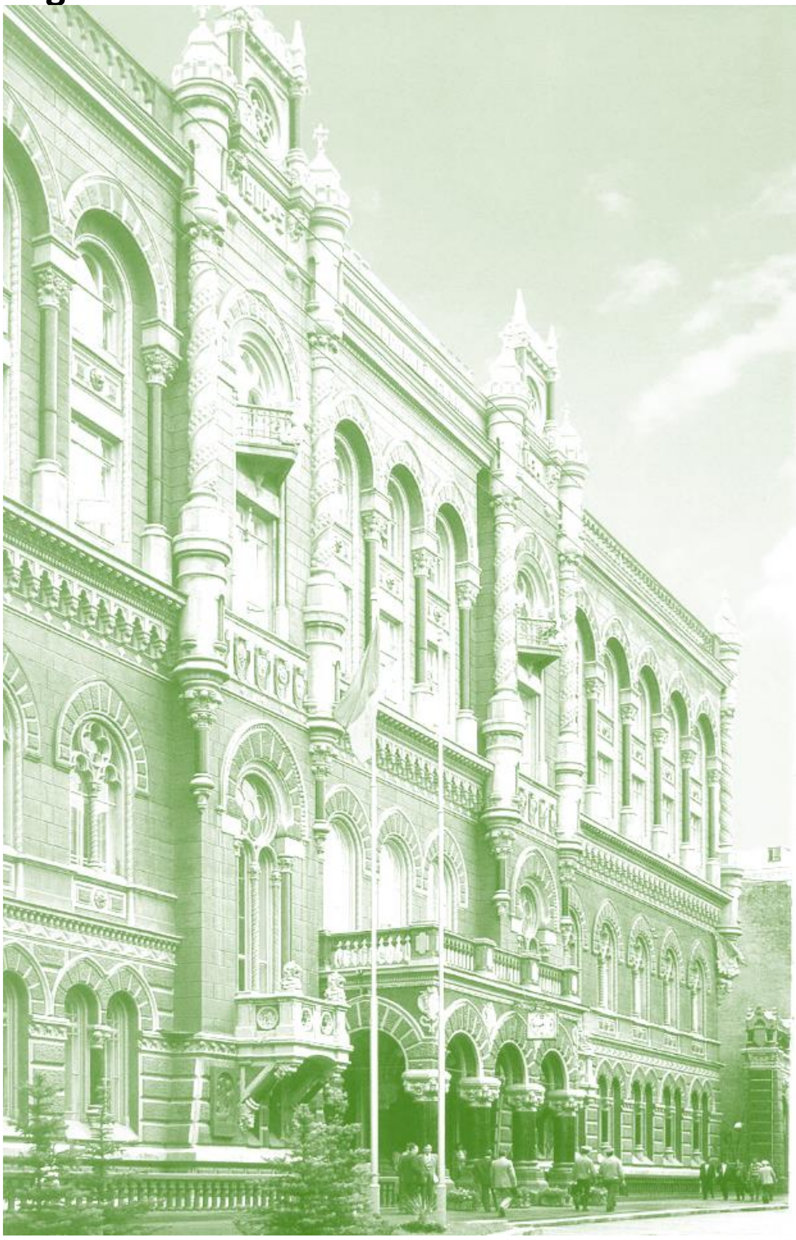
Macroeconomic and Monetary Review

NATIONAL BANK OF UKRAINE

August 2017



Monetary Policy and Economic Analysis Department

Summary

● Overall, the global price environment as measured by the index of changes in global prices for major Ukrainian export commodities ocontinued to improve in August 2017. Steel and iron ore prices showed the strongest growth, primarily on the back of rising demand from Asian countries. By contrast, grain prices dropped after the new harvest supplies massively entered the market. After edging up in late July, oil prices traded in a narrow range in August. Intensified geopolitical tensions triggered a flight to quality. Meanwhile, most emerging market currencies have strengthened since early August as the US Dollar continued to weaken against major currencies.

● In monthly terms, headline inflation decelerated to 0.2% in July 2017, from 1.6% in June, reflecting seasonal decline in prices for fruit and vegetables, as well as prices for clothing and footwear. Annual headline inflation slightly accelerated to 15.9%, primarily due to faster growth in raw food prices and a stronger impact of administered factors. Underlying inflation pressures remained moderate – core inflation stood at 0.1% mom and 7.3% yoy. The producer price index continued to decelerate to 23.3% yoy, driven by global commodity price developments.

●In July, the Index of Key Sectors Output decelerated sharply (to 0.4% yoy). This largely reflected an increase in comparison base after the transport difficulties, caused by the railway strike in eastern Ukraine during May-June last year, were resolved. As a result, in the reporting month, industrial production resumed decline (was down by 2.6% yoy), with the main contributors being the sectors that suffered the most from the halted trade with the non-government controlled area (metallurgy, mining, energy). Despite a slowdown, sectors, which performance often serves as a proxy for domestic investment (machine building and construction) and consumer demand (retail trade turnover), continued to grow at a fast pace. The dynamics of the agricultural production index has improved, as the paces of the harvesting campaign caught up from later start this year.

● Demand for labor remained solid. Average nominal wages continued to grow at a fast pace, slightly decelerating to 36.6% yoy amid slower economic activity in some sectors. Growth rates of real wages decreased to 17.2% yoy as inflation accelerated.

● In July, the state budget recorded a slight deficit (UAH 2.0 billion). This was the result of significantly lower revenues than in the previous month, although expenditures were also down. The slump in revenues was expected, as in June a surge in budget revenues was achieved due to dividend and lump-sum profit transfers by enterprises with state ownership. Meanwhile, revenues continued to grow at a fast pace in annual terms against a favorable comparison base (in July 2016 VAT proceeds were low due to a catch-up in VAT refunds for June 2016) and owing to the next transfer of the NBU's profit for the previous year. Local budgets returned to surplus (UAH 2.7 billion) due to lower expenditures. As a result, the consolidated budget also reported a surplus.

● The current account deficit moderately widened both compared to June this year and to July last year (to USD 594 million) as the merchandise trade deficit increased on the back of higher energy and machinery imports. Growth in goods exports slowed down primarily on account of grain and metallurgical exports. Net financial account inflows decreased marginally to USD 0.3 billion, reflecting the increase in the net external assets of the banking sector resulting from government redemption of domestic bonds denominated in foreign currency. FDI inflows also slowed down. In contrast to June, FDI came predominantly to the real sector in the form of equity capital. The overall BoP turned into deficit (USD 285 million) causing a decrease in international reserves to USD 17.8 billion as of the end of July, or 3.6 months of future imports.

● At its last monetary policy meeting the NBU Board decided to maintain the key policy rate at 12.5% pa. The decision reflected the need to mitigate risks to achieving the inflation targets. Despite the restrained monetary policy in recent months, market interest rates for hryvnia resources continued responding to policy easing in April-May, although this process has somewhat slowed down. The situation on the FX market remained favourable. This allowed the NBU to increase the volume of FX purchases to replenish international reserves without counteracting a gradual exchange rate appreciation in response to fundamental factors and to continue relaxing the previously implemented FX restrictions. The banks' deposit portfolio kept growing, which, together with a decrease in the cost of borrowed funds, contributed to a further revival in bank lending.

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