Macroeconomic and Monetary Review

NATIONAL
BANK OF
UKRAINE

October 2016

Monetary Policy and Economic Analysis Department

Summary

● In September, the external price environment for Ukrainian exporters worsened due to a fall in global grain, steel and iron ore prices. However, in late September and October, the global commodity markets showed signs of stabilization. Although oil prices edged up in late September on OPEC agreement to limit production, fundamentals continued to retstrain the effects of speculative factors. As a result, oil prices hovered around USD 50 per barrel in October. Amid prospects of a Fed rate hike and the ECB leaving its monetary policy unchanged, financial markets investors adopted a wait-and-see attitude in October.

● In September 2016, headline inflation slowed to 7.9% y-o-y, which was consistent with the NBU's forecast published in the Inflation Report (July 2016). The slowdown was largely due to a decrease in core inflation (to 6.3% y-o-y) and raw food inflation. In the meantime, the growth of administered prices and tariffs as well as fuel prices accelerated, as expected. Producer price inflation also sped up (to 19.6% y-o-y), driven mainly by global commodity prices and hryvnia exchange rate pass-through effects.

● IKSO growth accelerated to 5.8% y-o-y primarily thanks to a high harvest of grains, sunflower seeds and sugar beet. Agricultural output recovered annual growth, driven by a good harvest. The latter also spilled over into other sectors, underpinning a surge in the wholesale trade turnover and food manufacturing. It also supported cargo transportation, although the largest contribution to the sector's growth was made by higher natural gas imports and transit. Output growth acceleration in construction signaled that investment demand had remained high. However, retail trade and industry reported subdued growth.

● Labor demand continued to recover. Average nominal and real wages kept growing at a fast pace (by 23.7% y-o-y and 15.4% y-o-y, respectively).

● The state budget recorded a deficit of UAH 20.5 billion as expenditures rose significantly, while revenues decreased. The decrease in revenues was attributed to slower growth in tax revenues and lower non-tax proceeds, as compared with the previous year. This year, monthly performance of tax revenues is strongly affected by the statistical effect caused by changes in the corporate income tax administration and a rather uneven repayment of VAT refunds. In the meantime, the state budget expenditures expectedly grew, primarily due to scheduled external debt service payments. In addition, the surplus of local budgets narrowed to almost zero amid typical for the period acceleration in expenditures. As a result, the consolidated budget showed a deficit in September.

● The current account deficit widened to USD 875 million, reflecting scheduled interest payments on restructured Eurobonds and a wide merchandise trade deficit. Unlike in previous months, the financial account net inflows (USD 1.3 billion) were backed primarily by the public sector. Higher net private sector debt outflows were offset by a larger decrease in FX cash outside banks and an increase in FDIs to the real sector. Thanks to the overall balance of payments surplus (USD 474 million) and a third tranche under the IMF EFF, gross international reserves rose to USD 15.6 billion (or 3.7 months of future imports[1]) as of end-September.

● In October, the supply of foreign currency exceeded the demand for it in the FX market. This reflected improved public sentiments since mid-September on the back of the IMF decision to disburse the tranche, as well as signs that global commodity prices were stabilizing. The NBU purchased foreign currency to replenish international reserves without counteracting the appreciation trend. Given eased depreciation pressure on the hryvnia in the second half of September, domestic currency deposits recovered growth that month. The stock of domestic currency loans also increased. A further decline in risks to price stability enabled the NBU to continue easing monetary policy. Indeed, effective from 28 October 2016, the key policy rate was cut to 14.0%.

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 translation to English, readers should consider the Ukrainian version of the Report as correct.

[1]Reserves in months of imports were calculated on the basis of a new macroeconomic forecast, which was approved by NBU Board as of 27 October 2016, and which will be published in the Inflation Report (October 2016).