Macroeconomic and Monetary Review

NATIONAL BANK OF UKRAINE

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Monetary Policy and Economic Analysis Department

Summary

● Global commodity prices for Ukrainian exports barely changed in October compared to the previous month. After hitting a peak, steel prices adjusted downwards marginally due to ample supply in the market. Grain prices stayed at fairly low levels, despite a slight rise in wheat prices, on the back of improved expectations regarding harvest volumes and carry-over stocks. Oil prices showed an upward trend owing to high OPEC+ supply-cut compliance and lower US drilling activity. Emerging market (EM) countries continued to enjoy favorable environment in global financial markets. However, despite capital inflows to this group of countries, most EM currencies depreciated amid US Dollar appreciation.

● In September 2017 headline inflation stood at 16.4% in annual terms and 2% in monthly terms. Actual inflation in annual terms came in above the NBU's forecast published in the July 2017 Inflation Report. This primarily reflected a faster growth in raw food prices, rising production costs and a slight recovery in consumer demand. Core inflation at a rate of 7.7% yoy also came in above the forecast, although overall underlying inflation pressures remained moderate. In September 2017, the producer price index decelerated to 22.4% yoy (was up by 1.6% in monthly terms).

● The Index of Key Sectors Output decelerated in September (to 0.5% yoy), while the nine-month cumulative reading stood at 2.5% yoy. Industrial output declined by 0.3% yoy in September as performance of the machine-building and food production industries worsened. However, the growth in metallurgy and in chemical industry kept momentum. The growth in construction works slowed down, which, among other things, was attributed to lower capital expenditures of the budget and less favorable weather conditions than in the respective month last year. Consumer demand remained solid – growth in retail trade remained robust at 8.1% yoy, although decelerated slightly from the previous month. The agricultural production index, predictably, declined (by 3% yoy) due to lower crop yields and slower than last year harvesting works.

● In the course of 2017 labor demand was on a rise, but at a slower pace compared to the last year. In September 2017, the average nominal wages continued to grow at a fast pace (37.2% yoy). Also, real wage growth remained high (17.3% yoy). The number of households that were receiving the subsidies grew to 6.2 million (41.6% of the total number of households). The sharp growth followed a decline in May-June after formalities related to reapproving of housing subsidies had been arranged.

● In September, as expected, the state budget balance turned negative (UAH 23.7 billion), while local budgets rather unusually posted a deficit (UAH 3.5 billion). As a result, the consolidated budget reported a deficit. This outcome reflected primarily higher expenditures (in particular, for goods and services, wages, and a scheduled increase in debt service) and a slowdown in revenue growth due to lower non-tax proceeds. Meanwhile, the consolidated budget cumulative surplus remained significant, although narrowed to UAH 41.7 billion.

● In September, despite a further increase in energy and machinery imports, the current account deficit (USD 1 billion) remained at the previous year's level owing to stronger exports (primarily foods and transit services). Meanwhile, the current account deficit widened expectedly, compared to the previous months, due to scheduled interest payments on restructured government Eurobonds. Net financial account inflows increased (to USD 1.6 billion) over both the previous month and the same month last year. Successful placement of Eurobonds by the public sector was the main contributor to the financial account inflows, offsetting lower inflows to the private sector and a slower reduction in FX cash outside banks. Thanks to the overall BoP surplus (USD 0.6 billion), gross international reserves increased to USD 18.6 billion as of the end of September, or 3.7 months of future imports.

● At its last monetary policy meeting the NBU Board decided to hike the key policy rate by 1 pp to 13.5% pa, effective from 27 October 2017. The decision to tighten monetary policy was prompted by the need to return inflation to the target path and prevent further deterioration of inflation expectations. With the key policy rate kept unchanged in June – September, the decline in market interest rates for hryvnia resources has somewhat slowed down. However, that has not halted the growth of the banks' domestic currency loan and deposit portfolio.

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