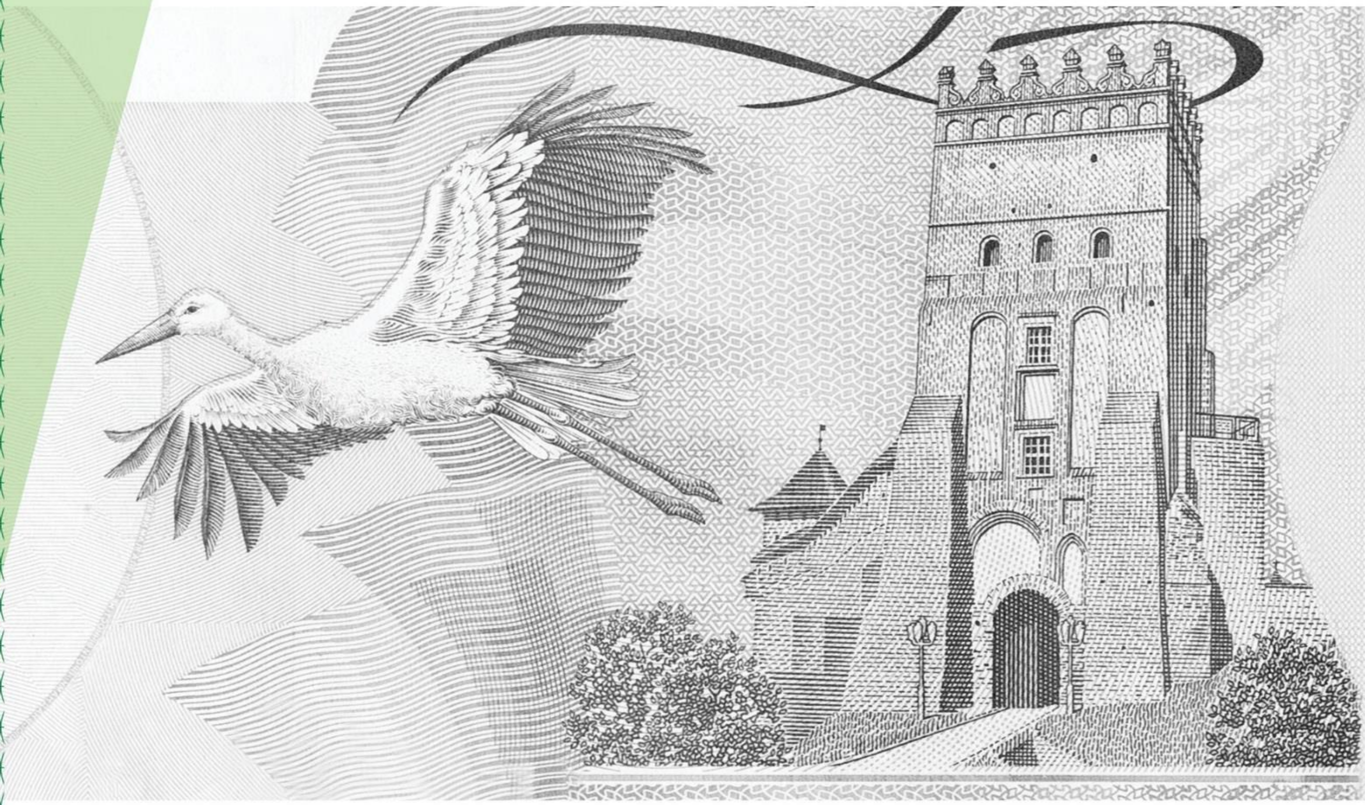
National Bank of Ukraine

Macroeconomic and Monetary Review

October 2018



SUMMARY

● The overall global price index measuring changes in world prices faced by Ukraine's exporters extended its moderate decline, primarily on account of steel prices. At the same time, iron ore and corn prices moderately icreased. Meanwhile, after hitting the four-year high in early October, oil prices have been decreasing. Emerging markets (EMs) continued to face the more challenging global financial environment, primarily due to further monetary policy tightening by the central banks in AEs. The stabilization measures undertaked by some most vulnerable EM countries (such as Argentina and Turkey) propped up the attractiveness of this group's assets to investors in late September through early October. However, the heightened turbulences on developed stock markets prompted investors to seek the safe haven assets, triggering capital outlows from EMs. As a result, most currencies of EM countries depreciated to US dollar. In contrast, Ukraine's FX market calmed in October due to increased FX supply from bank clients, primarily from agro enterprises, and households. The improved market sentiments amid progress in cooperation with the IMF contributed as well. In addition, the NBU maintained its presence on the market, helping contain exchange rate volatility.

● Consumer price inflation remained almost flat in September 2018, at 8.9% yoy, exceeding the upper limit of the target range (6.5% +/- 2 pp as of the end of Q3 2018). Despite lower food price inflation, inflationary pressure has remained elevated, fuelled by solid domestic demand, robust wage growth (23% yoy and 12.9% yoy in nominal and real terms, respectively), and a sharp increase in global oil prices. Thus, core inflation, at 8.7% yoy in September, remained at the previous month’s level and growth in fuel prices continued to accelerate.

● In January – September, the IKSO index growth slowed compared to its perfomance in the first half, to 3.3% yoy. Slower growth in industrial sector and domestic trade over the last few months amid cargo transportation difficulties and fading out favorable base effect were the major factors behind the slowdown. While performance of the mining industry improved, it failed to offset weaker growth in the manufacturing industry and in the supply of electricity and gas. At the same time, the growth in the IKSO index sped up in September, underpinned by high corn yields.

● In September, the state budget recorded a deficit (UAH 19.1 billion), albeit it was lower than last year due to a moderate expenditure growth. The latter, however, somewhat accelerated (to 5% yoy) compared to August, underpinned by higher capital spending. In contrast, revenue growth slowed down (to 15.6% yoy), partly due to a temporary factor – the transfer of a portion of the excise tax proceeds for several months to local budgets. Local budgets also reported a minor deficit (UAH 0.7 billion), primarily due to an increase in expenditures. Although the consolidated budget ran a deficit in September, it maintained the cumulative surplus (UAH 14.5 billion) for January – September.

● In September, the current account deficit widened (to USD 1.7 billion) due to a higher merchandise trade deficit and large scheduled debt service payments. In turn, the worsenening of the trade balance occurred amid a decrease in exports, while imports continued to rise at a steady pace. A decline in exports was attributed to a smaller harvest of early grains and lower carry-over stocks of technical crops, a decline in metallurgical production, and a worsening external price environment. Meanwhile, imports were supported by solid domestic demand and higher fuel prices. The current account deficit was only partially offset by financial account inflows (USD 1.1 billion), wholly generated by the private sector. As a result, the overall balance of payments reported a deficit (USD 0.6 billion), causing a further decline in international reserves, to USD 16.6 billion as of the end of September, or 2.8 months of future imports.

● NBU's key policy rate hikes in July and September along with the narrowing liqudity in the banking sector continued to transmit into higher market rates, in particular in the interbank market, and hryvnia sovereign bond yields. Bank retail interest rates also increased.

● At its last monetary policy meeting, the NBU Board decided to leave the key policy rate unchanged, at 18% per annum. This decision rested on the Board assessment that the current and forecast monetary conditions are sufficiently tight to bring inflation to its medium-term target of 5% in 2020.

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.