Macroeconomic and Monetary Review

NATIONAL BANK OF UKRAINE

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Monetary Policy and Economic Analysis Department

Summary

● External price conditions worsened in April 2017, due to a fall in steel and iron ore prices. The decline in prices was mainly driven by China's record steel and iron ore inventories. Grain prices stabilized at relatively low levels. Meanwhile, oil prices hovered between USD 50 – 55 per barrel. Geopolitical risks amid political uncertainty in the euro area increased risk aversion, pressuring EM currencies during most of April. However, global financial conditions improved after the outcome of the first round of the French presidential elections came out. As a result, most EM currencies against the US dollar that depreciated versus the basket of currencies amid concerns over worsening relations between the US and selected countries (such as North Korea, Russia, Syria).

● As expected, in March 2017, headline inflation accelerated to 15.1% yoy. Notably, raw food prices rose at a faster rate, driven by increased production costs, robust exports and a low base effect. Administered inflation picked up due to scheduled increases in some tariffs and excise taxes. Meanwhile, core inflation slowed down to 6.3% yoy, due to improving global commodity prices, which resulted in the strengthening of the hryvnia in February and March. In addition, PPI inflation, although remaining high at 38.3% yoy, decelerated moderately, driven by developments in global commodity markets.

● The Index of Key Sectors Output moderately increased in March (by 0.5% yoy). In annual terms, performance of all key sectors, apart from transportation, improved. Trade turnover growth resumed after a temporary decline in February. Also, a slight increase in animal husbandry output occurred, and growth in the construction sector sped up. At the same time, the halted freight traffic across the contact line in the Donetsk and Luhansk oblasts continued to weigh on economic in the mining industry, electricity production and freight turnover. Metallurgy was hit as well but the situation in the industry improved slightly after a sharp downturn in February as some plants stepped up production.

● Labor demand continued to revive. The growth of average wages in nominal and real terms accelerated (up to 37.2% yoy and 18.7% yoy respectively), reflecting a minimum wage increase at the beginning of 2017 and activity pick-up in selected sectors.

● The state budget deficit narrowed slightly compared to February (to UAH 11.1 billion), due to a significant slowdown in expenditures. More specifically, this occurred due to a decrease in expenses related to social assistance programs (housing subsidies and transfers to the pension fund). At the same time, the pace of revenue growth continued to decline. Primarily, tax revenues increased only marginally (up by 4.8% yoy), as expected, considering the high comparison base for the corporate income tax proceeds. In March, local budgets also recorded a deficit (UAH 2.9 billionbillion), mainly due to a slowdown in revenues. As a result, the consolidated budget deficit widened to UAH 14 billion.

● In March, the current account deficit widened to USD 783 million, due to scheduled interest payments on restructured government Eurobonds. At the same time, the merchandise trade deficit narrowed slightly driven by increased corn and oil exports. Net financial account inflows (USD 427 million) were primary generated by trade credit. FDI inflows increased marginally, although remaining modest at USD 61 million. Due to the overall BoP deficit (USD 0.4 billion), gross international reserves decreased to USD 15.1 billion, or 3.2 months of future imports, as of the end of March. However, owing to the disbursement of the next IMF's tranche under the EFF, and the second tranche of macro-financial assistance from the EU, gross international reserves had risen to USD 16.7 by April 5, 2017.

● The Board of the National Bank of Ukraine has decided to cut the key policy rate by 1 pp to 13%, effective from 14 April 2017. This decision was taken due to abating inflation risks amid declining inflation expectations, favorable FX market conditions and the successful completion of the review of the IMF`s financial assistance program. Interbank market rates continued to decrease in March, while retail interest rates responded more moderately. Continued attractiveness of bank deposit products amid further strengthening of the hryvnia significantly contributed to accelerating hryvnia deposit inflows into the banking system in March. However, lending activity remained weak.

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.