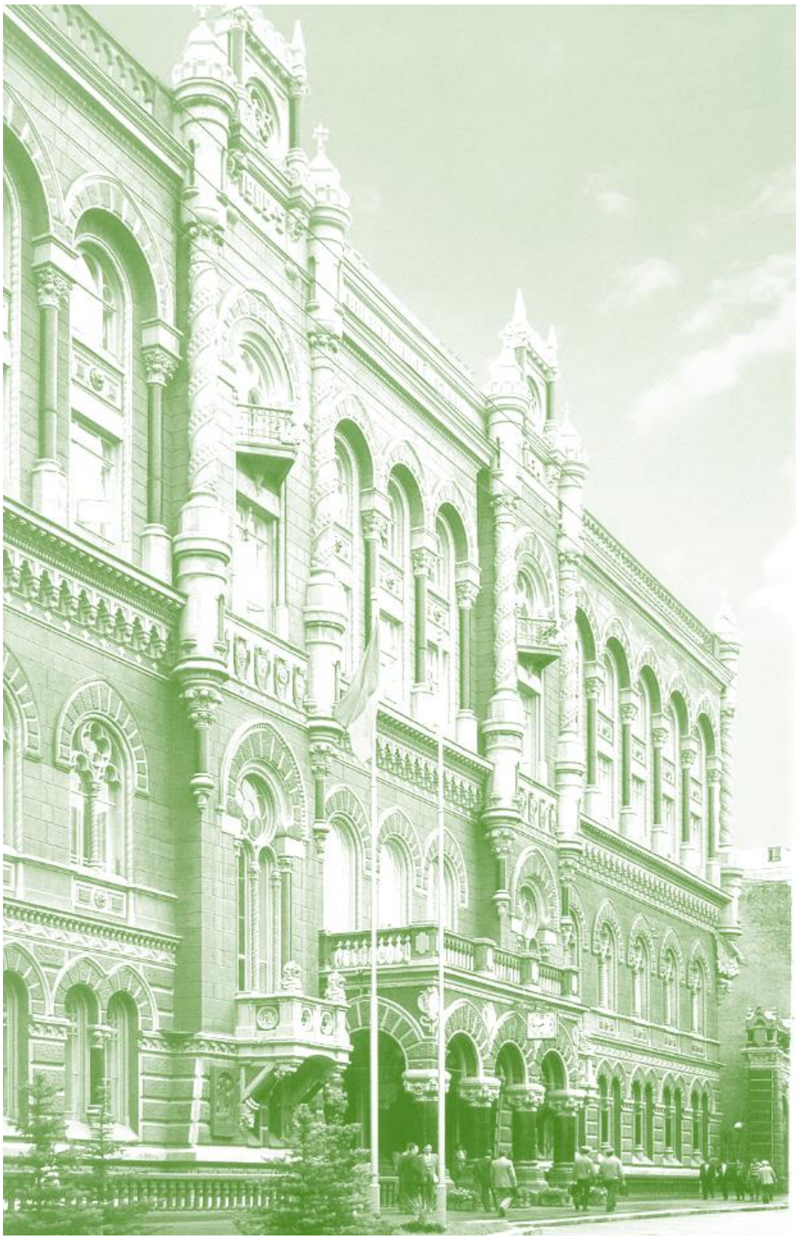
Macroeconomic and Monetary Review

NATIONAL BANK OF UKRAINE

September 2016



Monetary Policy and Economic Analysis Department

Summary

● In August, external price environment for the Ukrainian exporters worsened in aggregate, primarily due to a slump in sunflower oil and grain prices. Global steel and iron ore prices have followed a relatively favorable trend; however, they declined slightly in September, driven by a seasonal weakness in demand. Meanwhile, grain prices have shown signs of stabilization in September. Oil prices have been dragged down by fundamentals in September; however, they have edged up at the end of the month on OPEC agreement. Global financial conditions have worsened in September, mostly due to rising concerns that major central banks might tighten their monetary policy earlier than expected. In spite of this, EM financial assets showed resilience.

● In August 2016, as expected, headline inflation accelerated to 8.4% y-o-y in Ukraine, consistent with the NBU's forecast envisaging consumer inflation to return to 12% y-o-y by the end of 2016. The acceleration was driven by a rise in non-core inflation to 9.0% y-o-y, while inflationary pressures, driven by fundamental factors, continued to ease – core inflation slowed down to 7.4% y-o-y.

● IKSO growth sped up to 2.7% y-o-y. There were the signs that investment demand remained strong and consumer demand was reviving. In particular, industrial production rebounded, construction continued to increase at a solid pace and domestic trade growth accelerated. Meanwhile, agriculture contracted due to a shift in the terms of grain harvesting and a further decline in animal production.

● Labor demand kept recovering accompanied by a strong wage growth in both nominal and real terms (up by 23.7% y-o-y and 15.4% y-o-y, respectively).

● In August, the state budget showed a surplus (UAH 7 billion) due to a stronger revenues performance amid higher tax revenues. Proceeds from the corporate income tax accounted for the largest contribution to the revenues growth (owing to improved financial results of enterprises in H1 2016 and statistical effect of changes in the tax administration). At the same time, expenditures grew at a relatively moderate pace. Also, the local budgets' surplus widened to UAH 4.6 billion. As a result, in August the consolidated budget returned to a positive balance – UAH 11.6 billion.

● In August, the current account deficit widened to USD 414 million, mainly on account of a wider trade deficit. Although merchandise exports increased, imports grew at a faster pace, primarily due to higher energy imports. In addition, both investment and consumer goods imports continued to increase, supported by reviving domestic demand. As in previous months, the financial account net inflows (USD 417 million) were backed by the private sector. The FX cash outside banks continued to decrease, albeit at much lower pace. In contrast to previous months, FDI inflows were primarily directed to the corporate sector. Overall, Balance of Payments was close to zero; accordingly, international reserves remained virtually unchanged (USD 14.1 billion or 3.6 months of future imports) as of 31 August 2016.

● In the first half of September, depreciation pressures persisted on FX market, generated mainly by a seasonal increase in FX demand. Thanks to the NBU's actions to mitigate the exchange rate volatility and improved market sentiments on the back of the IMF decision to disburse the next tranche, hryvnia depreciation pressures have subsided considerably. In August, the stock of domestic currency loans increased, underpinned by a revival in demand from both non-financial corporations and households. A steady decline in inflationary pressures amid improved inflation expectations and a gradual economic recovery enabled the NBU to continue monetary policy easing. Effective from 16 September 2016, the key policy rate was reduced to 15.0%.

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.