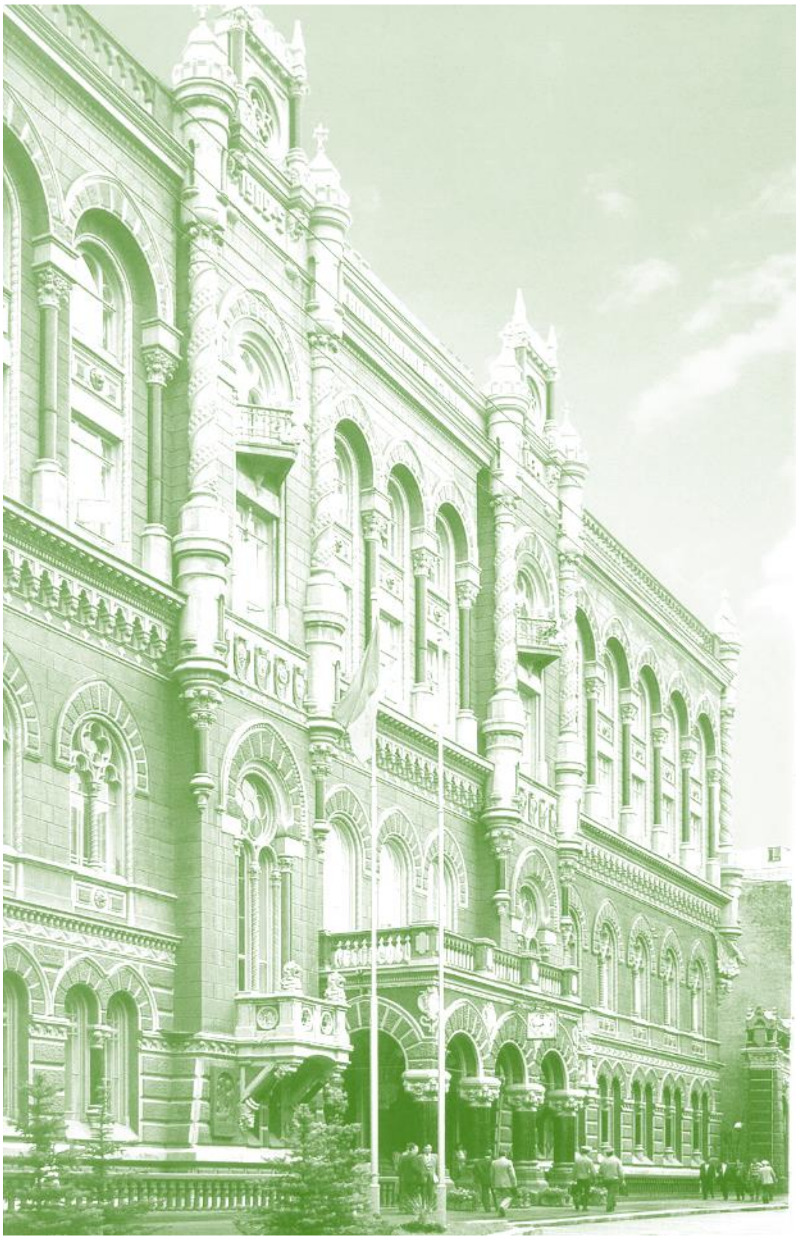
Macroeconomic and Monetary Review

NATIONAL BANK OF UKRAINE

December 2016



Monetary Policy and Economic Analysis Department

Summary

● In November and December, global price environment for key Ukrainian exports continued to improve. Thus, prices for steel, iron ore, nonferrous metals, fertilizers, and beef have risen. However, due to record harvests, grain prices remained at a fairly low level. Oil prices resumed growth in the run-up to enforcement of production freeze agreement by major oil producers. The situation in the world financial markets for EM countries has deteriorated significantly due to increase in sovereign bond yields in advanced economies, strengthening of the US dollar, and the Fed monetary policy tightening. Consequently, capital outflows from EMs accelerated while their currencies felt depreciation pressures.

● November saw an anticipated slowdown in headline inflation (to 12.1% yoy), mainly due to a steep decline in raw food inflation. Underlying price pressure also eased (core inflation moderated to 6.2% yoy). Current figures on CPI and its components were in line with our forecast published in the Inflation Report (October 2016) and confirmed that headline inflation for 2016 should be close to the central point of target range (12% +/- 3 ppts). At the same time, producer prices continued to accelerate (to 32.0% yoy), primarily reflecting an increase in gas prices for industrial consumers as well as pressure from global commodity prices.

● In November, IKSO growth slowed down to 3.2% yoy. The main factors behind the slowdown were a deceleration in the agriculture growth (due to the statistical effect of a higher weight assigned to animal production, which recorded a further decline) and a decrease in the wholesale trade turnover. In the meantime, industrial output sped up due to renewed growth in the mining industry, a pick-up in metallurgy and food processing. Besides, owing to seasonal sales, retail trade surged up. Acceleration in construction output signaled that investment demand continued to recover at a fast pace.

● The labor market has seen a steady demand for labor force. The nominal average wage gained pace (up to 20.2% yoy). This, alongside the slowdown of inflation, supported the acceleration in real wages (to 8.4% yoy). The acceleration was observed mainly in the industries and sectors which showed continued output growth as well as in public administration.

● The State budget recorded a surplus for the second consecutive month with the anticipated expansion in November (to UAH 14.8 billion), primarily thanks to a robust increase in revenues. The acceleration in budget revenue growth was ensured by both higher tax proceeds (in particular, due to quarterly tax payments) as well as nontax receipts (due to significant NBU transfers of its previous year profit to the budget). At the same time, the expenditure growth was relatively moderate. The local government surpluses also increased. As a result, the consolidated budget reported a surplus of UAH 16.8 billion - the highest for the recent years in November.

● In November, the current account deficit narrowed compared with October due to a decrease in the trade deficit. In November, unlike previous years, both exports and imports of goods edged up in value terms compared with the previous month with export growth exceeding that of imports. Besides, an increase in natural gas transit to the European countries facilitated an increase in the services surplus. Net inflows in the financial account diminished primarily due to slower decline in cash outside banks. In addition, the real sector carried out significant repayments under trade credits. Due to a deficit in the overall balance of payments (USD 80 million) and valuation effects, international reserves slightly declined to USD 15.3 billion (covering 3.6 months of future imports) as of 30.11.2016.

● A gradual monetary policy easing in April-November facilitated further decline in the cost of financial resources in domestic currency. In December, the NBU Board decided to keep its key policy rate unchanged. A pause in monetary policy easing cycle was prompted by the need to mitigate growing inflation risks and to enable the NBU to meet the inflation targets for 2017-2018. In November, signs of lending activity revival strengthened further. The growth of hryvnia deposits suspended, primarily due to a decrease in deposits of the non-financial corporations, a typical development this year in the months of quarterly tax payments and fees. Instead, household deposits in domestic currency continued to increase. The situation in the FX market in November - first half of December remained relatively calm. However, at the end of December, despite favorable fundamental external factors, depreciation pressure on the hryvnia heightened.

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