Macroeconomic and Monetary Review

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Summary

● In late 2016 – early 2017, Ukrainian exporters saw an improved price environment amid higher monthly average prices for steel, iron ores, grains, and fertilizers. High raw material prices, an expected reduction in China's steelmaking and coal mining capacities, and the final US anti-dumping duties against China supported steel prices. Grain prices resumed growth driven by temporary factors, which had a significant impact on expectations of winter grain crops while also increasing corn demand. Emerging market (EM) countries faced more benign global financial conditions as capital flows recovered to these countries. The shift in capital flows occurred as investors were seeking to minimize losses due to uncertainties about the policies of the new US President and the US dollar weakening. Under these conditions, EM currencies mostly strengthened.

● In 2016, headline inflation fell sharply to 12.4%. Thus, the inflation target of 12% ± 3 ppts for 2016, defined in the Monetary Policy Guidelines for 2016-2020, was achieved. The rapid disinflation slowdown was attributed to easing underlying inflation pressures. This is evidenced by a sharp decline in core inflation (to 5.8% yoy). Additionally, raw food prices were pressured downwards by a number of supply-side factors. Meanwhile, increases in administered tariffs and higher global oil prices were the main drivers behind price increases in 2016.

● IKSO accelerated sharply to 14.4% yoy in December. Agricultural production (up by 66.4% yoy) made a major contribution to the output increase, mainly due to high maize harvest. The high industrial crop harvest in 2016 also buoyed the food industry (particularly, oil and sugar manufacturing), which, in turn, contributed to the acceleration of industrial production as a whole (to 4.5% yoy). Further improvements in agriculture and industry supported wholesale trade. Freight turnover accelerated significantly owing to higher energy imports and transit volumes of natural gas. Growth in retail trade turnover remained relatively strong thanks to improved consumer confidence and the faster growth of household income.

● Labor demand lost momentum in December. Besides seasonal factors, this may be attributed to firms' cautious approach towards expansion of their staff ahead of the upcoming twofold increase in the minimum wage. In the meantime, the growth of average monthly wages accelerated in both nominal and real terms (to 23.8% yoy and 11.6% yoy, respectively), boosted by the increase in the minimum wage from 1 December 2016 and the recovery of economic activity in most sectors.

● As expected, the state budget showed a deficit of UAH 24.6 billion in December, albeit lower than in December 2015. Despite the traditional expansion in expenditures, they remained virtually flat compared with December 2015. Meanwhile, state budget revenues were significantly higher, although their annual growth slowed down due to unprecedented VAT refunds. Local budgets also expanded their expenditures rapidly, recording a deficit of UAH 20 billion. Despite the significant consolidated budget deficit posted in December, the entire year's deficit was relatively moderate (UAH 54.7 billion).

● In December, the current account deficit widened to USD 292 million, mainly due to an increase in the trade deficit. The value of merchandise exports barely changed compared with the previous month, while imports growth accelerated primarily due to higher energy imports. In the financial account, net inflows (USD 653 million) were backed primarily by the reduction of banking sector assets. Debt flows of the private sector were almost balanced. Thanks to an overall balance of payments surplus (USD 359 million), gross international reserves rose to USD 15.5 billion (or 3.4 months of future imports[1]) as of the end of December.

● At its recent monetary policy meeting, the NBU Board decided to maintain its key policy rate at 14%. This decision was taken in order to mitigate foreign exchange and inflation risks while aiming to fulfill the inflation targets for 2017-2018. In December and the beginning of 2017, market interest rate developments were affected mostly by a structural shift in the banking system of Ukraine due to the transfer of CB PrivatBank PJSC to state ownership. December saw a significant increase in both household and corporate deposits, up by 8% yoy and 13.8% yoy respectively. At the same time, lending activity remained subdued – the annual growth of domestic currency loans in 2016 by 17.5% was largely attributed to the restructuring of FX loans.

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.

[1] Reserves in months of future imports were revised in accordance with the new macroeconomic forecast (approved by the Board of the National Bank of Ukraine as of 26 January 2017), which will be published in the Inflation Report (January 2017).