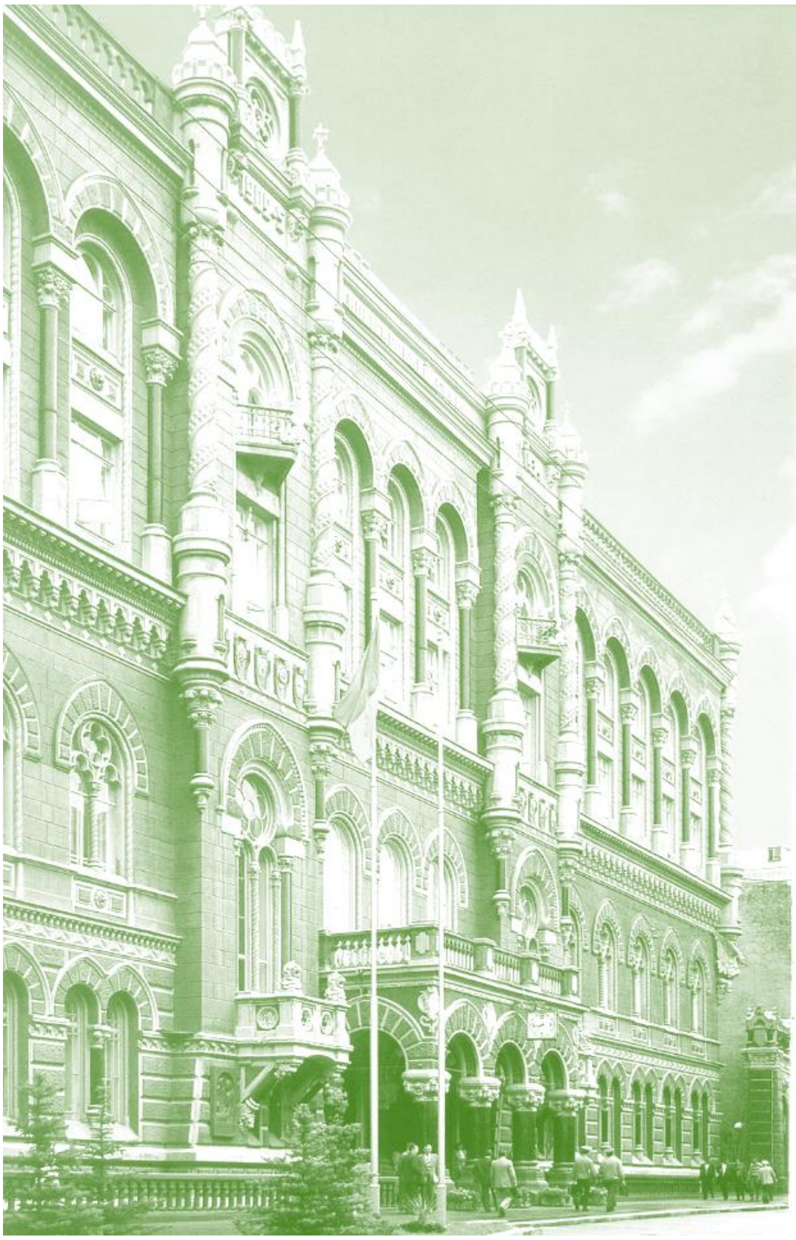
Macroeconomic and Monetary Review

NATIONAL BANK OF UKRAINE

March 2017



Monetary Policy and Economic Analysis Department

Summary

● The commodity price environment continued to improve in March 2017, despite a drop in grain prices. Steel and iron ore prices remained relatively strong amid increased demand, primarily, from the US and India, and anti-dumping duties in place against producers of several countries. Grain prices declined, mainly due to aggressive sales of the record-high harvest aimed at raising sufficient funds for the sowing campaign. Oil prices, after trading in a relatively narrow range in the past two months, fell reacting to growing oil production in the US. Emerging market countries remained attractive to overseas investors due to overall favorable global financial market conditions and improved growth prospects for this group of countries. Most EM currencies have also benefited from a weaker US Dollar.

● In February 2017, both headline and core inflation accelerated (to 14.2% yoy and 6.4% yoy respectively). This moderate pick-up was expected and occurred across the main CPI categories due to higher production costs and against a low base of comparison. At the same time, supply-side factors and improved conditions in global commodity markets (the latter resulted in the strengthening of the hryvnia exchange rate) restrained the CPI growth. However, global commodity price developments spurred producer inflation to 38.9% yoy.

● Following a prolonged period of growth, the Index of Key Sectors Output decreased by 0.9% yoy. The decline reflected the first effects of the transport blockade in the east of the country as well as a higher base of comparison. Mining and metallurgical production performance sharply deteriorated, and total industrial production was down by 4.6% yoy. The blockade also adversely affected the freight turnover and the wholesale trade. Meanwhile, a decline in agricultural production slowed down.

● Labor market saw an ongoing recovery in labor demand. The growth of average wages decelerated marginally in nominal and real terms (to 35.4% yoy and 18% yoy, respectively) following the recent significant acceleration.

● The state budget reported a sizable deficit (UAH 14.4 billion). It resulted from a significant slowdown in tax revenue growth that reflected, primarily, a catch-up in VAT refund payments following a minor refund in January and significant expenditures, mainly for utility subsidies and social security. The local budget surplus narrowed (to UAH 7.3 billion) also due to considerable expenditures. As a result, consolidated budget balance turned negative in February (UAH 7 billion).

● In February, the current account deficit widened to USD 399 million due to higher merchandise trade deficit. In particular, export growth slowed both due to the fading temporary effect of the previous year's low comparison base and lower grain exports. Imports also decelerated, but remained considerable, inter alia due to high energy imports. Net inflows in the financial account (USD 368 million) were generated by a further reduction in FX cash outside banks and rising trade credits (USD 505 million on accounts payable). FDI inflows remained modest amounting to USD 45 million. As overall BoP balance was close to zero (-USD 27 million), gross international reserves as of the end of February remained virtually unchanged (USD 15.5 billion or 3.3 months of future imports).

● In early March, the Board of the NBU decided to hold off from monetary policy easing, in order to mitigate risks for the achievement of inflation targets in 2017 – 2018. This decision affected market interest rates too. Although they generally continued to decline gradually driven by lagged effects from a series of the key policy rate reductions in previous periods, ample liquidity in the banking system and the favorable situation on the FX market, the trend has flattened. In February, the inflow of hryvnia deposits recovered, primarily thanks to household deposits. However, bank lending activity remained weak.

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