



National Bank
of Ukraine

Ukraine: Macroeconomic and Policy Outlook

Dmytro SOLOGUB

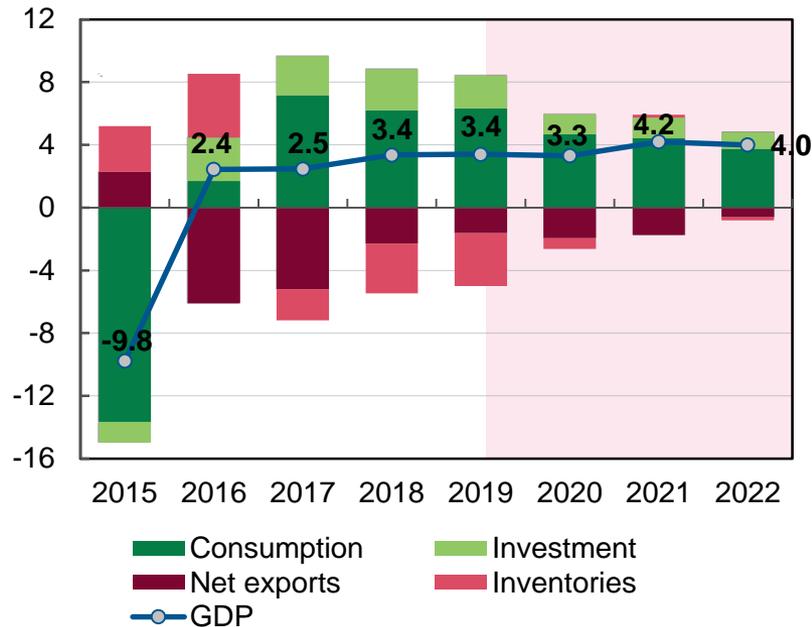
Deputy Governor

January 2020



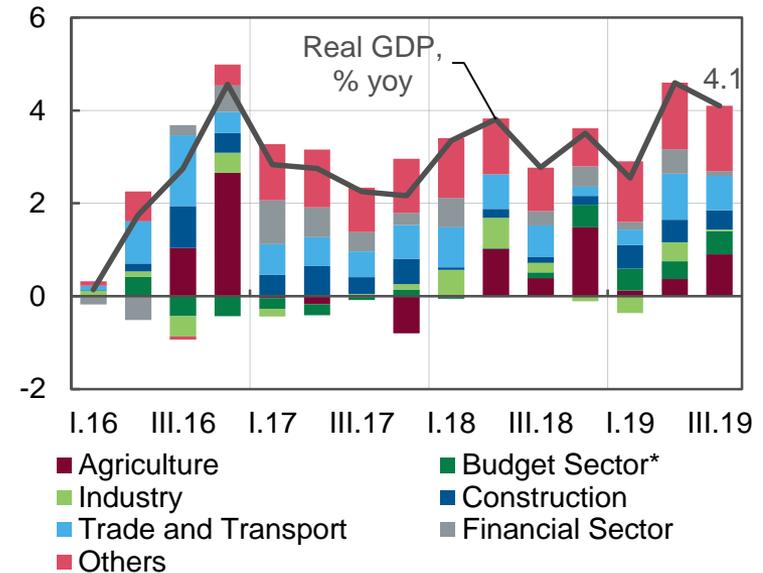
The Ukrainian economy has been recovering at a solid pace

Contributions to real GDP Growth, pp



Source: SSSU, NBU estimates and forecast (Inflation Report January 2020).

Contributions to annual real GDP growth by sectors, pp

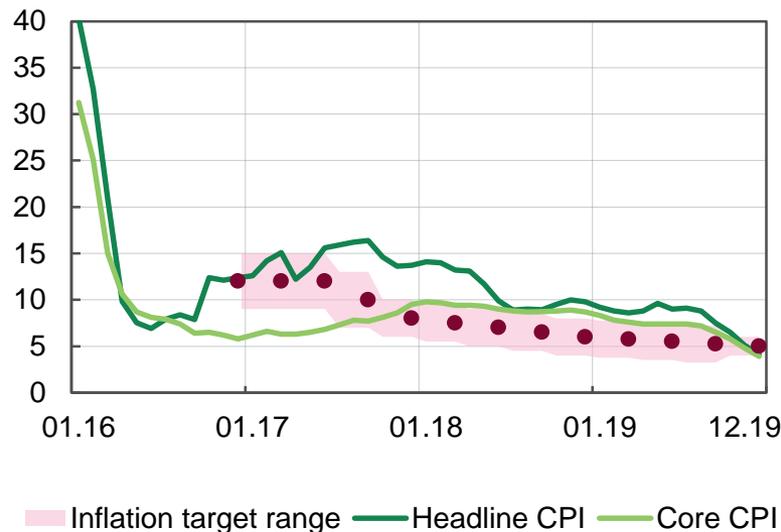


*Incl. public administration and defense; education; healthcare; administrative and support service; professional activities; arts and entertainment, etc.

- In Jan-Sep 2019, real GDP grew by 3.8% yoy, driven by strong domestic demand and relatively favorable terms of trade. In the sectoral terms agriculture (boosted by another record high harvest), trade and financial services contributed most
- The domestic demand, fueled by monetary policy easing and still robust income growth will remain the main growth driver in the years ahead

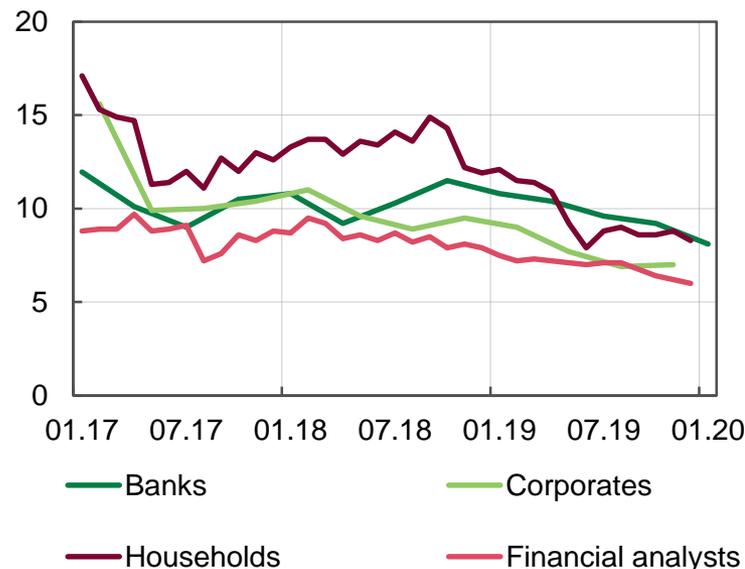
Consumer inflation decelerated to 4.1% in 2019. Thus, the NBU achieved its inflation target of 5% ± 1 pp

Headline and core inflation, % yoy



Source: SSSU, NBU.

Inflation expectations for the next 12 months, %

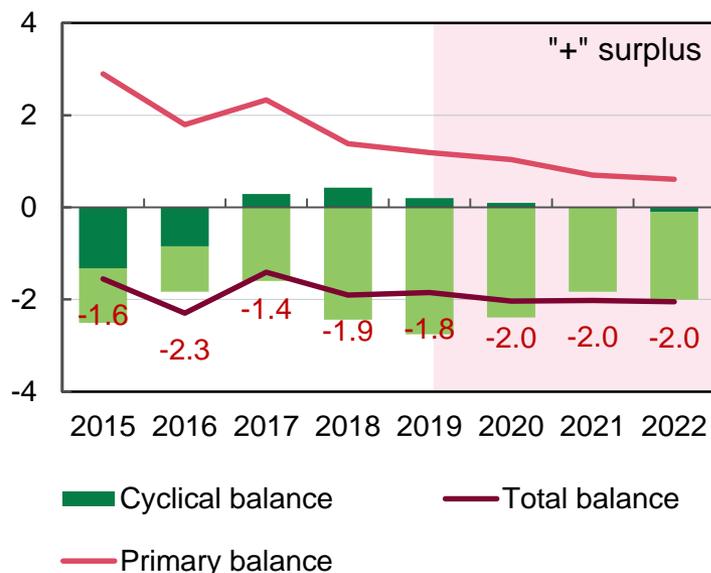


Source: NBU, GfK Ukraine surveys.

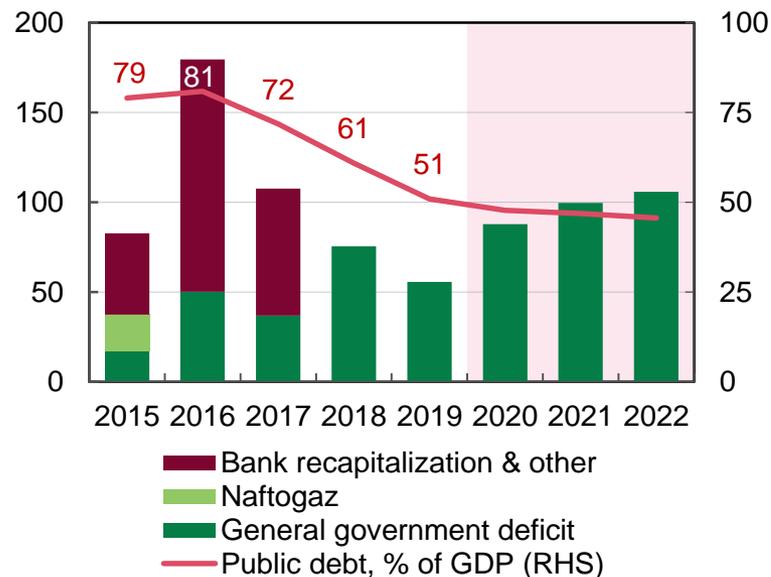
- The fall in inflation to its target in 2019 mainly resulted from the NBU's consistent monetary policy aiming to deliver price stability, and the government's prudent fiscal policy
- The key contributor was the strengthening of the hryvnia exchange rate due to capital inflows and rising productivity, particularly evident in the agricultural sector. The drop in the prices of the energy resources and subsiding pressures from the supply of food also contributed
- The inflation expectations of households, financial analysts, businesses and banks have been improving as well

Fiscal policy remains largely in check. Public debt-to-GDP ratio decreased rapidly

Consolidated Budget Balance, % of GDP



Public sector deficit, UAH bn, and public debt-to-GDP ratio, %



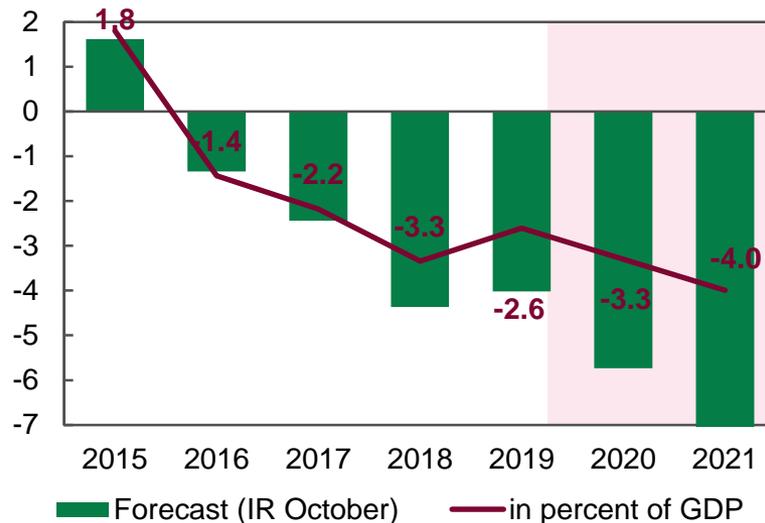
Source: MFU, NBU staff estimates and forecast (Inflation Report October 2019).

Source: MFU, SSSU, NBU staff estimates and forecast

- Ukraine has achieved remarkable progress in fiscal consolidation, wiping out large quasi-fiscal energy deficit
- The consolidated fiscal deficit hovers at about 2% of GDP as the government faces large public debt financing needs in 2019-2021
- In four years, the public debt-to-GDP ratio fell from 81% to just 51% of GDP. In addition, the currency structure of the debt has been improving

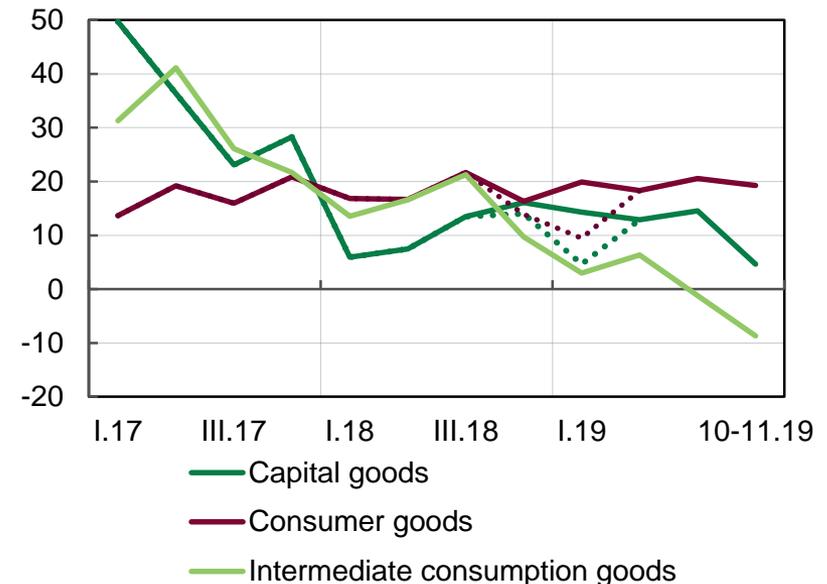
The CA deficit remains at the sustainable level ($3\% \pm 1$ pp)

Current Account Balance



* 2019 – NBU flash estimates
 Source: NBU, Inflation Report October 2019.

Imports by broad economic categories*, % yoy



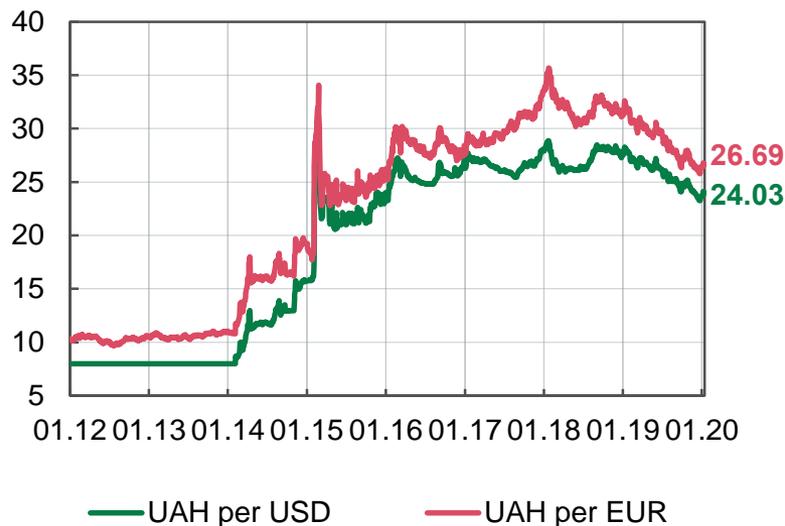
dotted lines – excluding registration of foreign cars imported in previous periods

Source: NBU.

- In 2019, the CA deficit narrowed to 2.6% GDP, despite appreciating currency, driven by better terms of trade (i.e. plunging imported energy prices combined with flat grain prices and relatively small decrease in steel prices) and record high harvests in 2018-2019
- Both consumer and investment imports have been rising at steady pace despite stronger domestic currency
- In 2020-2021, the CA deficit will remain sustainable, despite a decrease in gas transit revenues

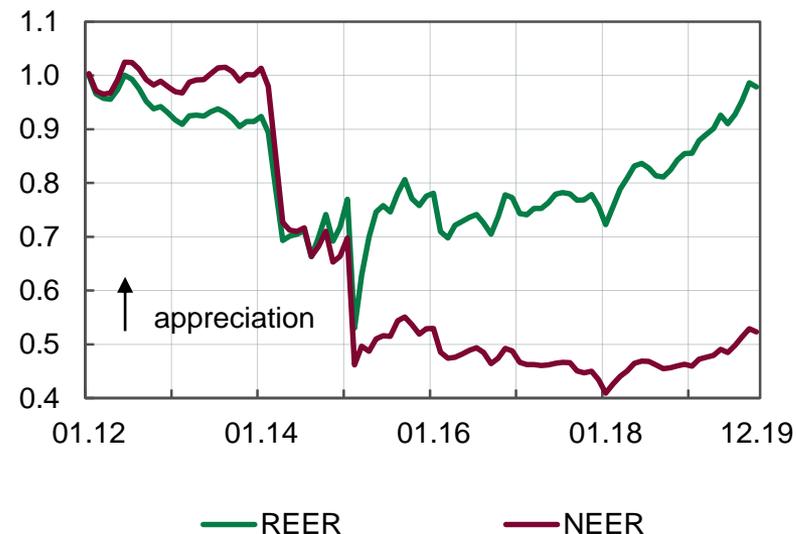
In 2019, hryvnia gained 15% to USD, thus partially erasing overshoot and underinvestment losses of the past few years

The Official Hryvnia Exchange Rate*



* The latest data points are for 15 January 2020.
Source: NBU.

Hryvnia REER and NEER indices, monthly average, 12.2011=1

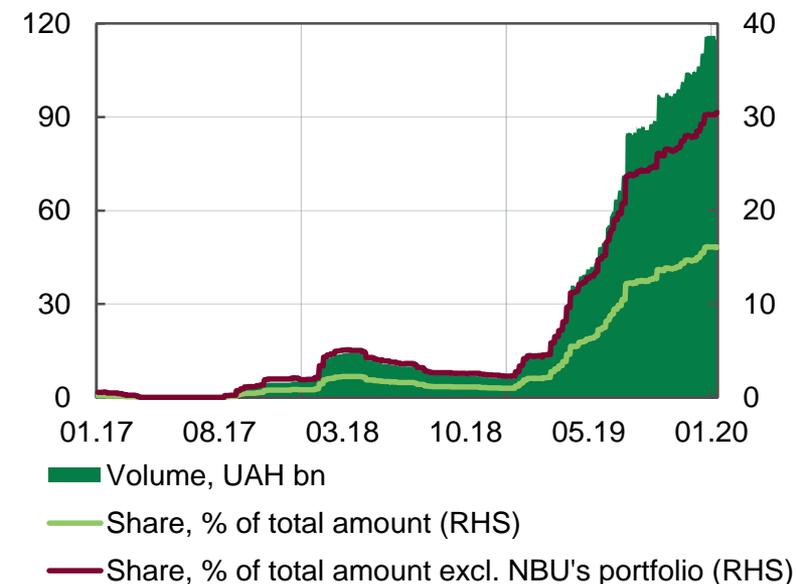


Source: NBU's estimates.

- NEER/REER of the hryvnia strengthened by 18.3% yoy and 19.1% yoy as of December 2019
- Favorable FX conditions supported by record high harvest, lower energy imports and non-residents' interest in hryvnia bonds were among principal contributors

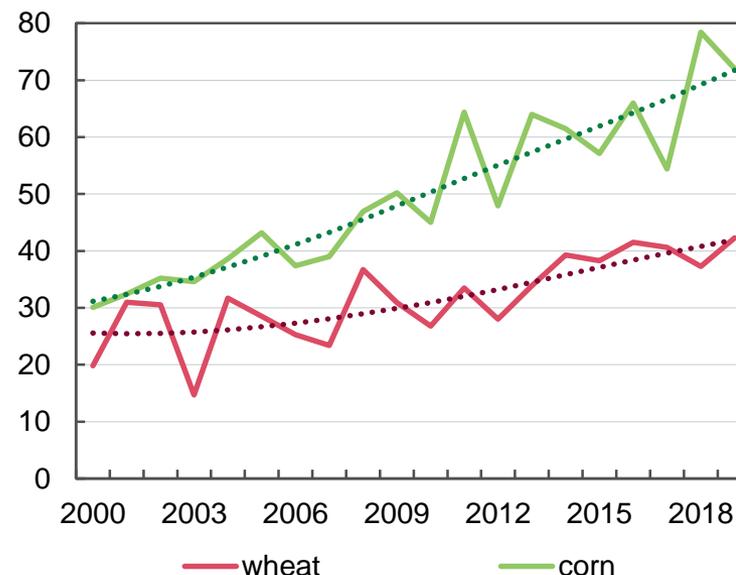
Hryvnia appreciation was driven by strong portfolio inflows and boosting agricultural output

Hryvnia Domestic T-Bills and Bonds Held by Non-Residents



Source: NBU.

Wheat and corn yields in Ukraine, centers/ha

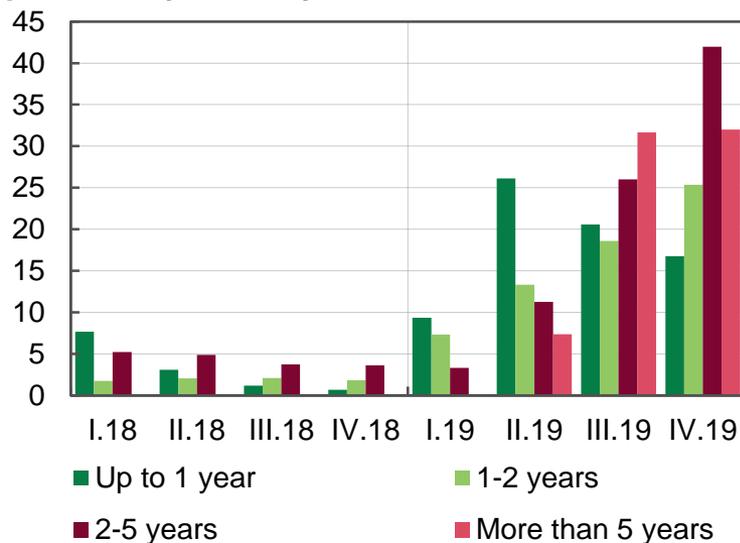


Data for 2019 – NBU estimate.
Source: SSSU.

- Foreign investments in hryvnia domestic bonds increased by around USD 4.3 bn during 2019
- Over the past 5 years, wheat and corn yields grew 24% and 16% over the average for the previous 5 years (34% and 60% for 10-year averages, respectively)
- A strong increase in productivity of the agricultural sector was the compound impact of investments into agro machinery and seeds, better use of fertilizers and improved skills

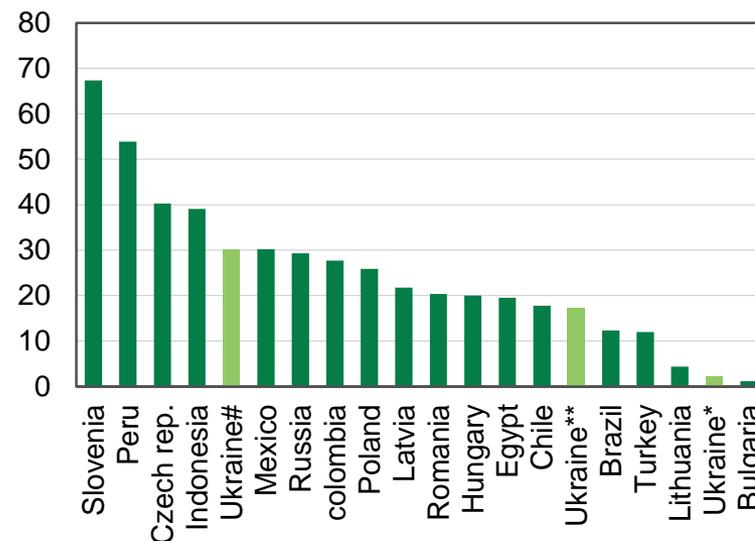
Myth 1: UAH appreciation is not in line with fundamentals due to the speculative nature of capital inflows

Hryvnia government bonds in non-residents' portfolio by maturity, UAH bn



Source: NBU.

Non-residents share in Government Bonds in Local Currency in 2Q2019, % eop



Note: Excluding NBU portfolio in case of Ukraine

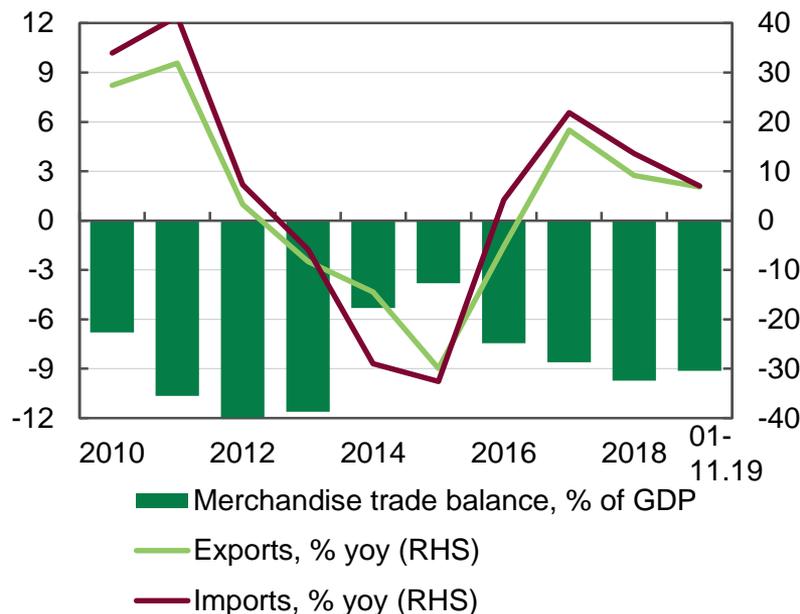
* As of 01.01.2019, ** as of 01.07.2019, # as of 01.01.2020

Source: NBU, IMF.

- Non-residents invested in hryvnia government bonds along all maturities up to 6 years. Unlike in the past, more than 60% of bonds in the non-resident portfolio have maturity over 2 years
- The share of non-residents in hryvnia government bonds increased to 30% in 2019, which is between the average shares for EM countries (~20% as of mid-2019) and select advanced economies (~45% as of mid-2019)

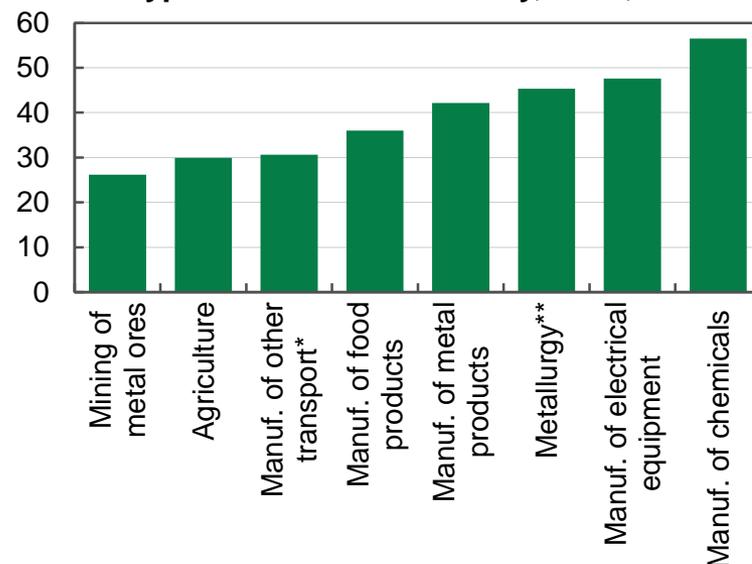
Myth 2: UAH appreciation is not in line with fundamentals due to the deteriorating external position

Merchandise trade balance indicators



Source: NBU.

Import content of exports (incl. secondary effects[#]) by selected types of economic activity, 2017, %



Including imports used in intermediate consumption by other sectors, used in the production of the final product of the respective exporting sector

* Incl. manufacture of freight wagons and their components.

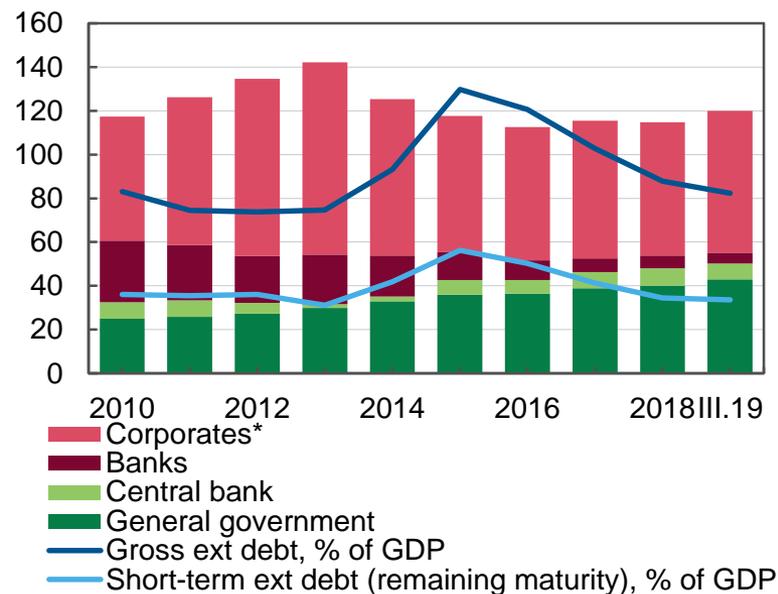
** Incl. production of base ferrous and non-ferrous metals.

Source: SSSU, NBU staff estimates.

- In 2019, despite hryvnia appreciation trade deficit narrowed due to ToT improvement
- Exporters' losses from domestic currency appreciation should be adjusted by cost-saving due to the cheaper imports

External sustainability indicators of Ukraine have been improving despite large external debt repayments

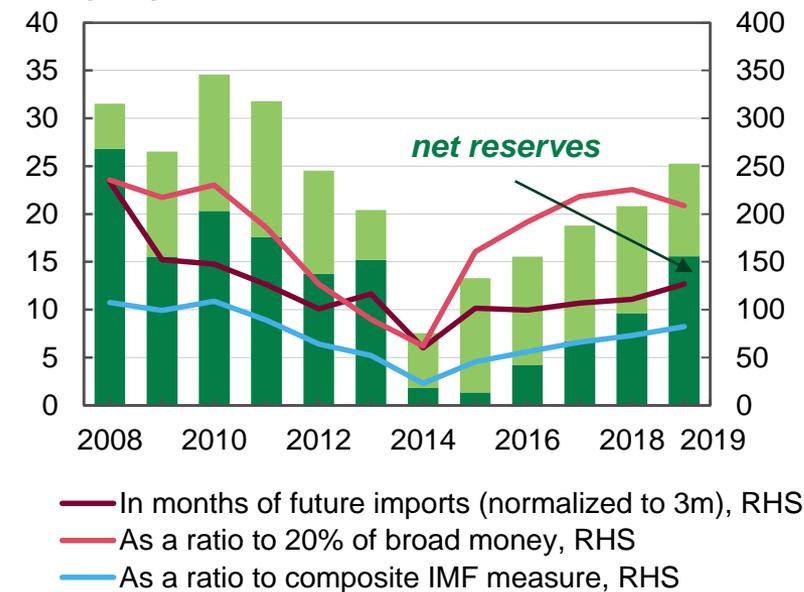
External debt, USD bn



* Including intercompany lending.

Source: NBU.

International Reserves, USD bn, and Select Adequacy Criteria, %

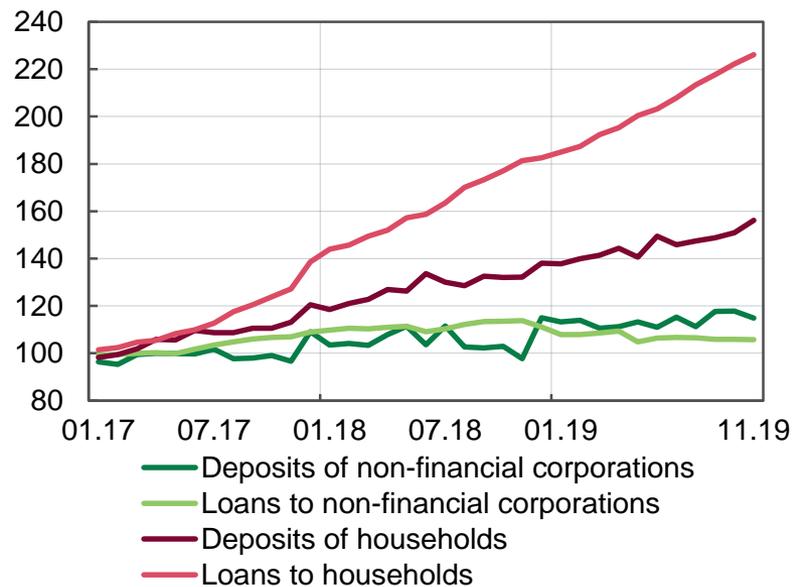


Source: NBU staff estimates.

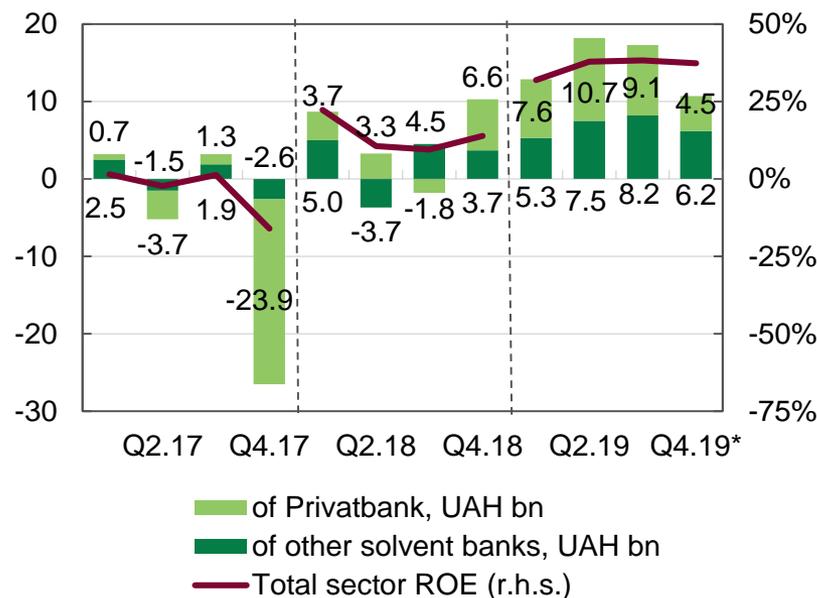
- External debt-to-GDP ratio decreased to 82.3% as of end September 2019 due to robust economic growth and stronger hryvnia
- Despite the pick-up in external debt repayments in 2018-19, FX reserves jumped to 7-year maximum of USD 25.3 bn by end-2019, bringing reserve adequacy ratios close to the levels last seen in 2011

Both loans and deposits are growing, mostly UAH-denominated

Hryvnia Loans and Deposits, 12.2016=100



Banking system net profit, UAH billion



* in two months of Q4

Source: NBU.

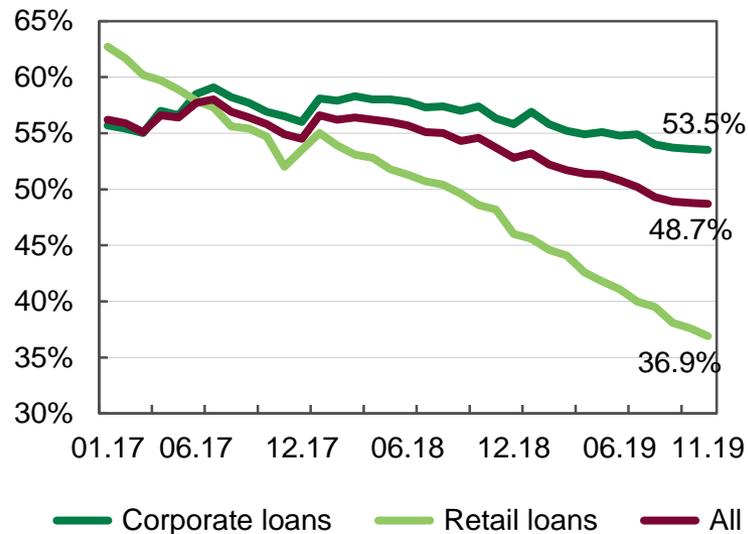
Source: NBU.

- Strong increase in nominal wages, attractive interest rates, particularly on the back of hryvnia appreciation, and improved inflation expectations contributed to the inflow of households' UAH deposits
- Sluggish corporate lending is a reflection of banking sector clean-up (including statistical effects of insolvent banks' exclusion from data) and institutional bottlenecks (e.g., judiciary weaknesses). Consumer loans have been growing fast

In January - November 2019, the sector's profit was UAH 59 billion (+3.0 times yoy), CIR is 48.1%, total sector ROE is 37.4%

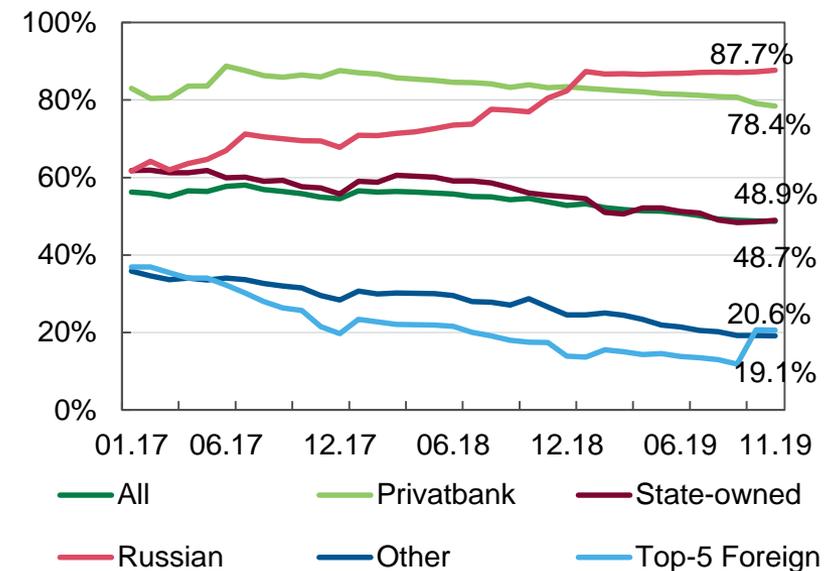
The NPL ratio is still high, but shows a solid downward trend

NPL portfolio ratio



Source: NBU.

NPL portfolio depending on the ownership of the banks



Source: NBU.

- The large share of NPLs is mainly caused by PrivatBank legacy portfolio – the companies related to its former shareholders, which stopped to serve their loans shortly after the bank was nationalized in late-2016
- The rest of SOBs actively used restructuring tools in 2018-19
- For private and foreign-owned banks NPL level is moderate and tends to decrease.

Main risks

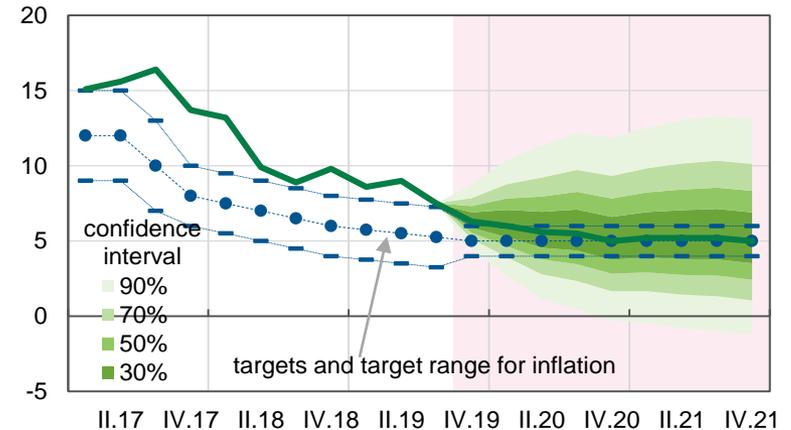
External:

- Global trade wars and terms of trade deterioration
- Escalation of military conflict and trade relations with Russia

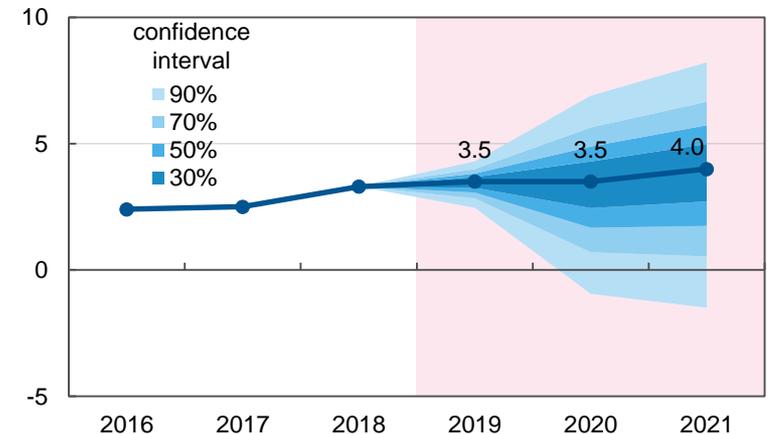
Domestic:

- Suspension of cooperation with IMF
- High inflow/outflow of non-residents in/from local G-bonds

CPI Forecast and Inflation Targets, % yoy



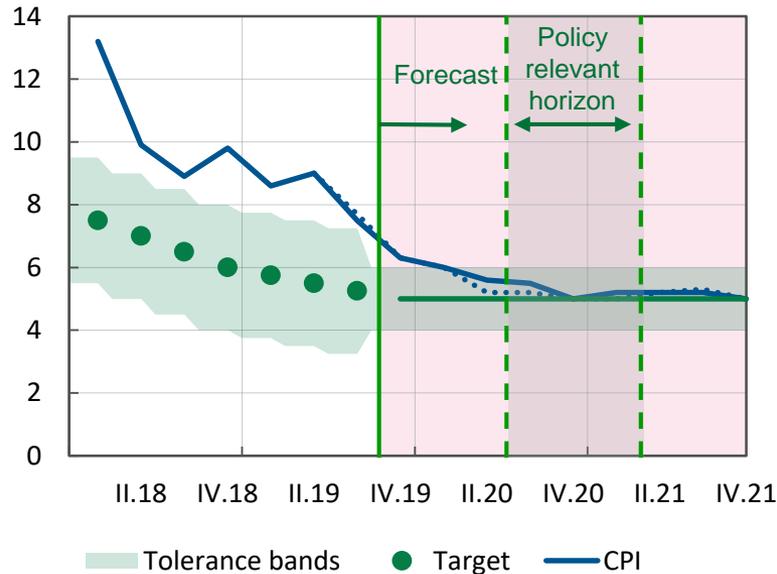
Real GDP Forecast, % yoy



Source: NBU (IR Oct 2019).

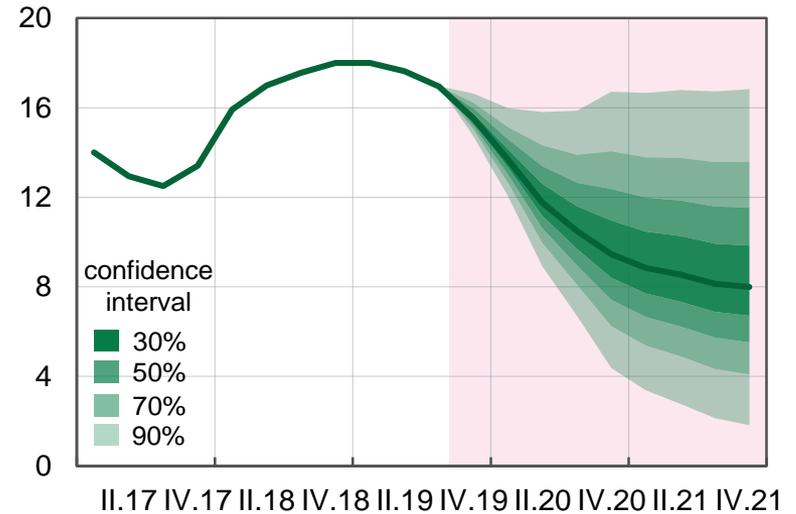
Monetary policy is committed to bring inflation to 5% target in 2020 via monetary conditions consistent with disinflation

Headline CPI, % yoy



Source: NBU (Inflation Report October 2019).

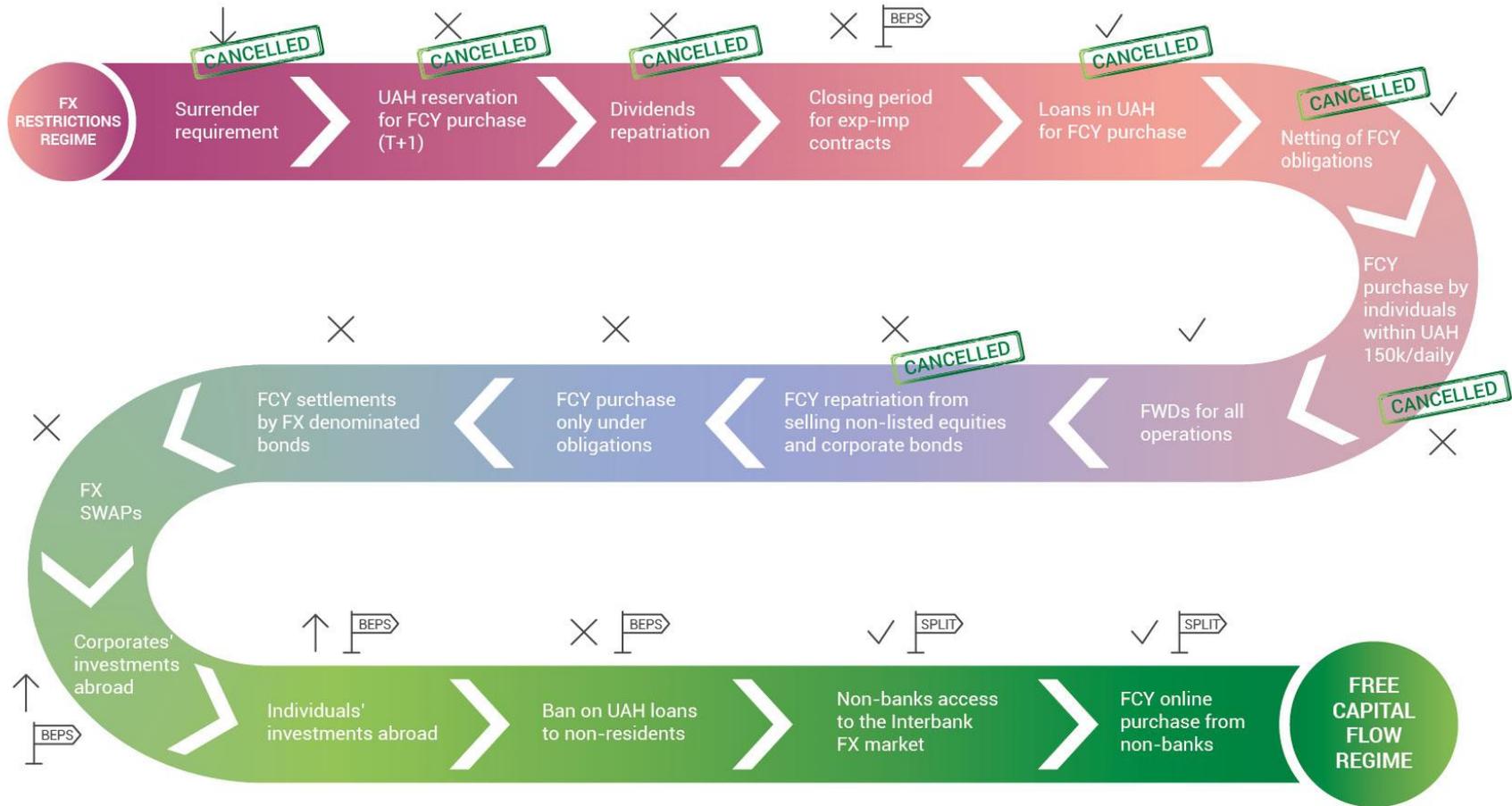
Key policy rate, average, %



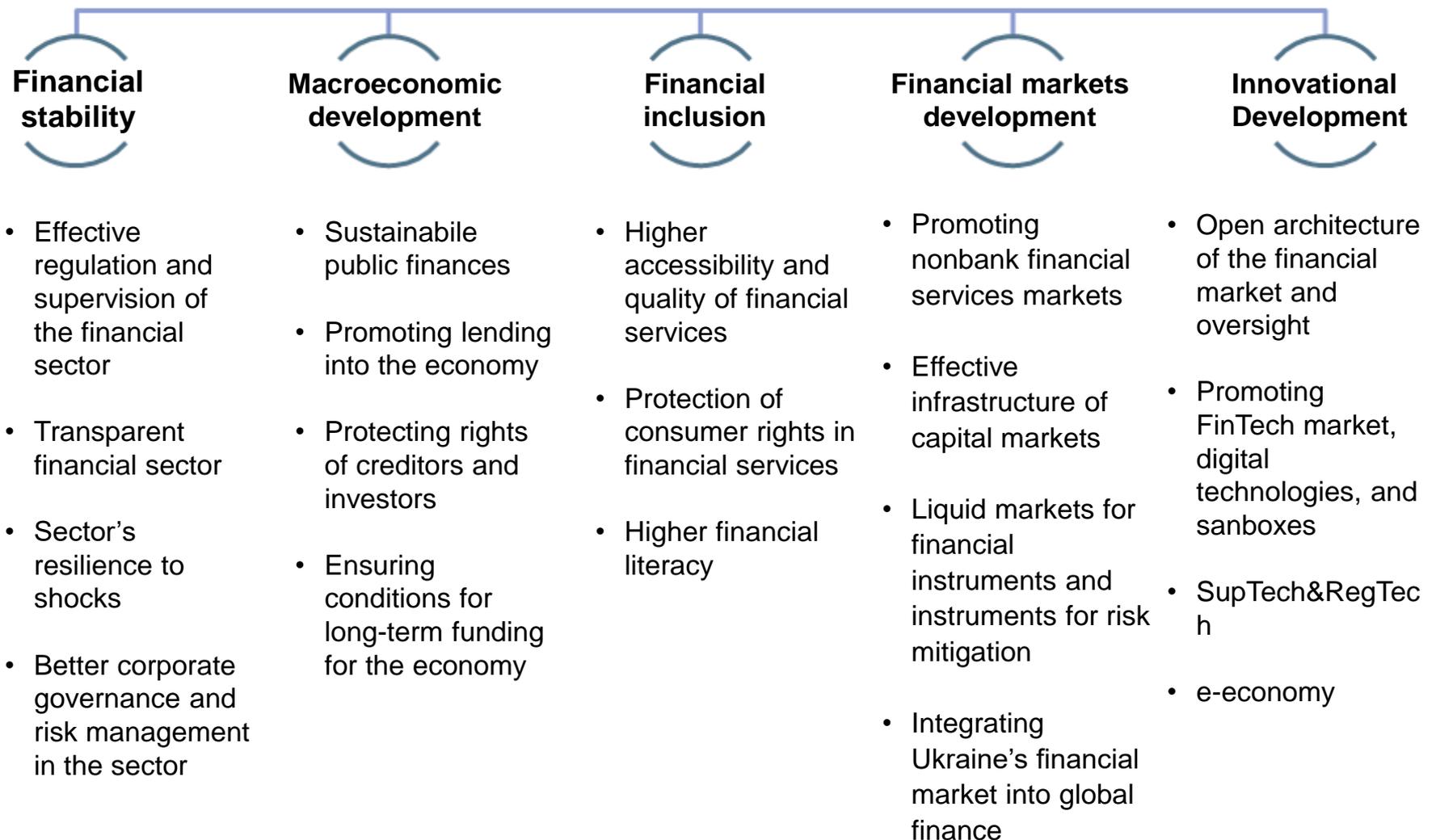
Source: NBU (Inflation Report October 2019).

The road map for cancelling FX restrictions

(According to the dynamics of macroeconomic preconditions improvement)



High-level strategic areas and objectives of the Ukrainian financial sector development until 2025



Roadmap for Strategy-2025 identifies 268 actions within 74 measures



Open architecture of the financial market and oversight



Deoffshorization/
unshadowing of the economy
BEPS and voluntary disclosure of earnings



Proportionality of regulatory requirements
Harmonization of regulatory approaches and standards



Capital markets development
Integrating hryvnia financial instruments into global finance



Development of technologies and their implementation in:
- RegTech, SupTech, compliance
- FinTech, remote channels, cashless, integration of market players



Protection of consumer rights and personal data



Sustainable fiscal position



Accessibility of financial services
Inclusion, financial literacy



Market conduct standards



Promotion of lending



e-Government



Demonopolization



Dedollarization

Key messages

- Ukraine's economy embarked on the recovery path in 2016, thanks to improved macroeconomic management, strong support from donors, and a favorable external environment
- Stable low inflation and flexible exchange rate are the “new normal” in Ukraine. The NBU monetary policy is aiming at keeping inflation around 5% target
- Fiscal and external sustainability have improved remarkably over the last few years, but risks remain amid threats of a full-scale global trade war and global recession
- The longer-term prospects of the economy remain strongly dependent on the realization of key structural reforms, which have to tackle major weaknesses such as the poor business climate, unfavorable demographics and deteriorating infrastructure
- NBU policy efforts will focus on securing price and financial stability, revamping the banking system and liberalizing the capital account



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