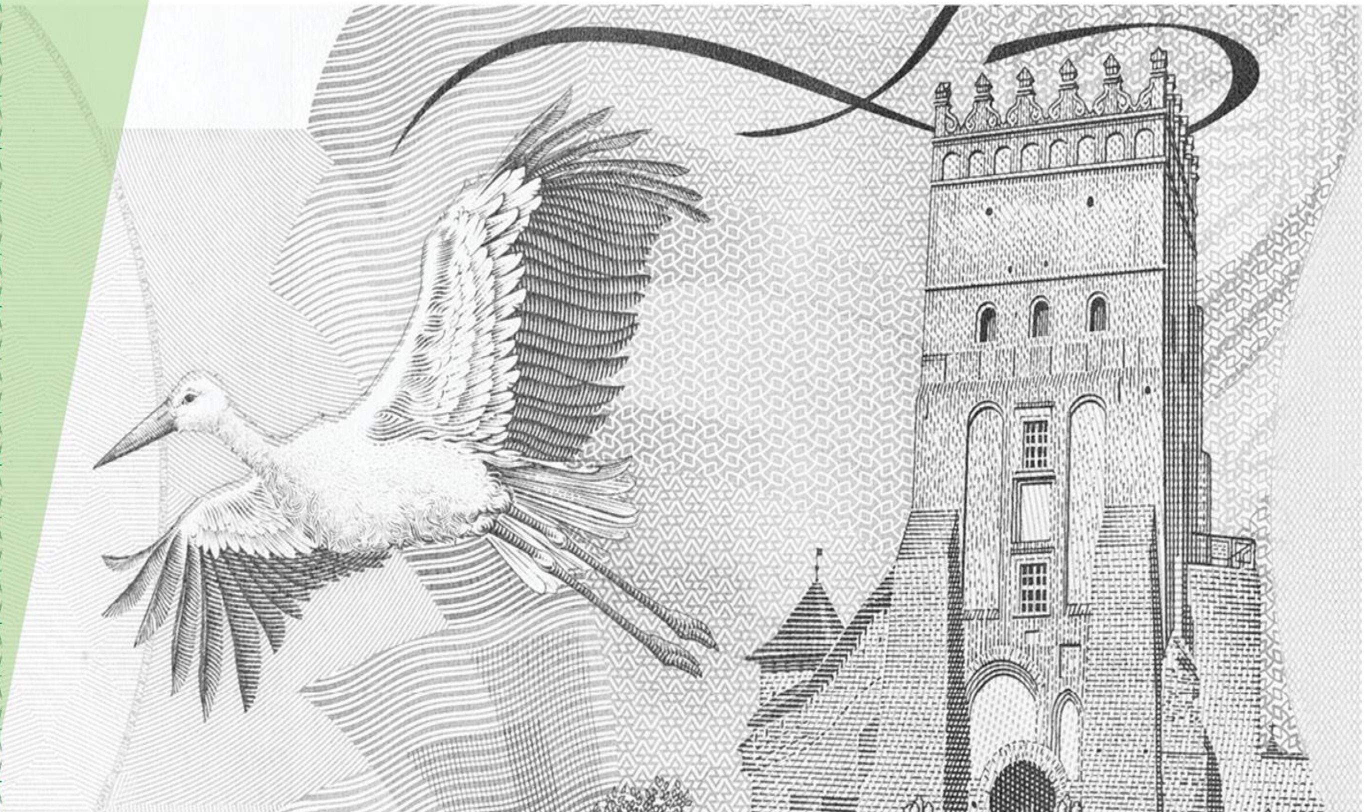
National Bank of Ukraine

Macroeconomic and Monetary Review

February 2021



Summary

External Environment

In February 2021, the external environment remained favorable as economic activity continued to recover amid the rollout of vaccination. This supported high global commodity prices. Oil prices rose due to unexpectedly and unusually significant purchases by China, deeper output reduction by some OPEC+ countries than required under their quotas, and extreme frosts in the United States, which reduced production. In contrast, natural gas prices adjusted downwards due to the thaw in Europe. Prices for steel and iron ore fluctuated in a narrow band, remaining high, amid Lunar New Year's Eve celebrations in China, the largest player in these markets. Wheat prices were also relatively stable: a record harvest in Australia offset Russia's export restrictions and the risk of winter crops in the United States being damaged by frost. Meanwhile, corn prices surged as a result of China's record-breaking purchases, logistical hurdles in the United States, and a more-significant-than-expected drawdown of global corn stocks. In the global financial markets, except for the last few days of the month, foreign investors continued to prefer EM assets as the most profitable. At the end of February, a sharp increase in bond yields due to expected rise in inflation tested the market. This partially offset the appreciation of EM currencies against the U.S. dollar observed during most of the month.

Inflation

As expected, consumer inflation in January 2021 accelerated (to 6.1% yoy, up from 5.0% yoy in December 2020), breaching the upper bound of its 5% ± 1 pp target range. Core inflation accelerated to 5.0% yoy (up from 4.5% yoy in November). Rising prices for certain foods, fuel, and higher administered prices for a number of goods and services, as well as further growth in consumer demand, generated pro-inflationary pressures. In particular, food prices rose faster due to poorer harvests of some crops, reduced production, and higher production costs. A planned hike in excise taxes made tobacco products more expensive. The price of electricity increased after the preferential price for households was canceled. At the same time, the growth in natural gas prices slowed slightly as natural gas suppliers lowered their January prices.

Growth in producer prices accelerated sharply (to 17.6% yoy in January). This was primarily due to higher prices for Ukrainian exports (chemicals, metallurgy products, edible oils and fats).

Economic Activity

The IKSO declined again in January (by 3.7% yoy after growing by 9.2% yoy in December 2020). Among other factors, the tightening of quarantine restrictions and adverse weather conditions had an adverse effect on a number of sectors. Specifically, consumer demand and exports weakened temporarily. In particular, the growth in retail trade turnover slowed (to 3.5% yoy). Transportation difficulties affected freight transport and wholesale trade. Industry returned to decline (by 4.0% yoy) due to a temporary weakening of domestic demand, tighter competition in foreign markets for metals-and-mining products, and disruptions in seaport operation. In addition, the downturn in agriculture resumed (by 5.7% yoy), reflecting low profitability of livestock farming, primarily due to higher feed prices and outbreaks of animal disease in some areas. Construction fell (by 12.9% yoy), adversely affected by weather conditions.

Labor Market

Nominal and real wage growth slowed somewhat in January, in part due to the lockdown. However, the growth rates remained high (15.0% yoy and 8.3% yoy, respectively), in particular due to the increase in the minimum wage. Labor demand and supply revived after the end of the quarantine and because of seasonal factors.

Fiscal Sector

The state budget ran a moderate deficit of UAH 5.7 billion in January. Revenues increased significantly, by about 30% yoy. This was driven by the recovery of demand and imports of excisable goods at the end of 2020, the hryvnia's weakening compared to last year, higher volumes of customs-cleared natural gas, and better administration of certain taxes. At the same time, expenditures grew moderately (by 8.0% yoy), and were largely arranged to finance healthcare and social programs. Financing for the budget deficit and other budget needs came from domestic borrowing and previously accumulated funds. As is typical for the month of January, local budgets ran a surplus (of UAH 12.5 billion). As a result, the consolidated budget recorded a surplus of UAH 6.7 billion.

Balance of Payments

In January, the current account surplus widened (to USD 0.8 billion) compared to previous months due to a significant reduction in nonenergy imports. Despite more favorable prices, exports of goods declined by 6.3% yoy in January. The main factors behind this decrease were the drawdown of last year's crop inventories and the tighter competition in some markets for metal-and-mining products. Adverse weather conditions also played their role by causing seaport disruptions. As a result, the supply of grains and edible oil products shrank significantly, and the growth in exports of metal-and-mining products slowed materially. At the same time, the January lockdown led to a drop in imports of goods (down 4.2% yoy), primarily those designated for consumer and investment purposes. Instead, the decline in energy imports slowed significantly due to higher natural gas prices in the global markets and increased purchases of petroleum products and coal.

The financial account generated USD 1 billion in capital outflows in January, primarily due to repayments on external liabilities by the real sector and some banks. At the same time, sustained nonresident interest in hryvnia domestic government debt securities ensured capital inflows into the public sector.

The small balance of payments deficit resulted in gross international reserves declining by 1.1% mom in January, to USD 28.8 billion. This covers 4.7 months of future imports.

Monetary Conditions and Financial Markets

The UONIA, the reference rate for borrowing costs in the interbank market, hovered at the lower bound within the NBU's interest rate corridor in February. The reason the UONIA stood at almost the level of rates on overnight certificates of deposit (5%) was a significant liquidity surplus in the banking system. The yields on domestic government debt securities dropped across all maturities. This was due to strong demand and the government's supply caps on securities with maturities of up to one and a half years. Measures by the Ministry of Finance to stimulate demand for domestic government debt securities with longer maturities contributed to the growth in their share. As these securities offer higher yields, the overall weighted average yield on hryvnia domestic government debt securities barely changed for the month.

Weighted average rates on hryvnia banking products in January remained almost at the level of the previous month. At the same time, annual hryvnia deposit inflows to banks continued to be high, while lending was rather subdued. However, banks are optimistic about the prospects of resuming lending and increased funding in the next 12 months.

The supply of foreign currency in the FX market surpassed the demand in February. As a result, the hryvnia was, on average, stronger against the U.S. dollar than in January. This allowed the NBU to buy foreign currency to replenish international reserves. Based on data for the month, net FX purchases of the NBU amounted to USD 0.2 billion.

The Macroeconomic and Monetary Review is a translation of the original report in Ukrainian. If there are any discrepancies between the original document and its English translation, readers should consider the Ukrainian version of the report as correct.