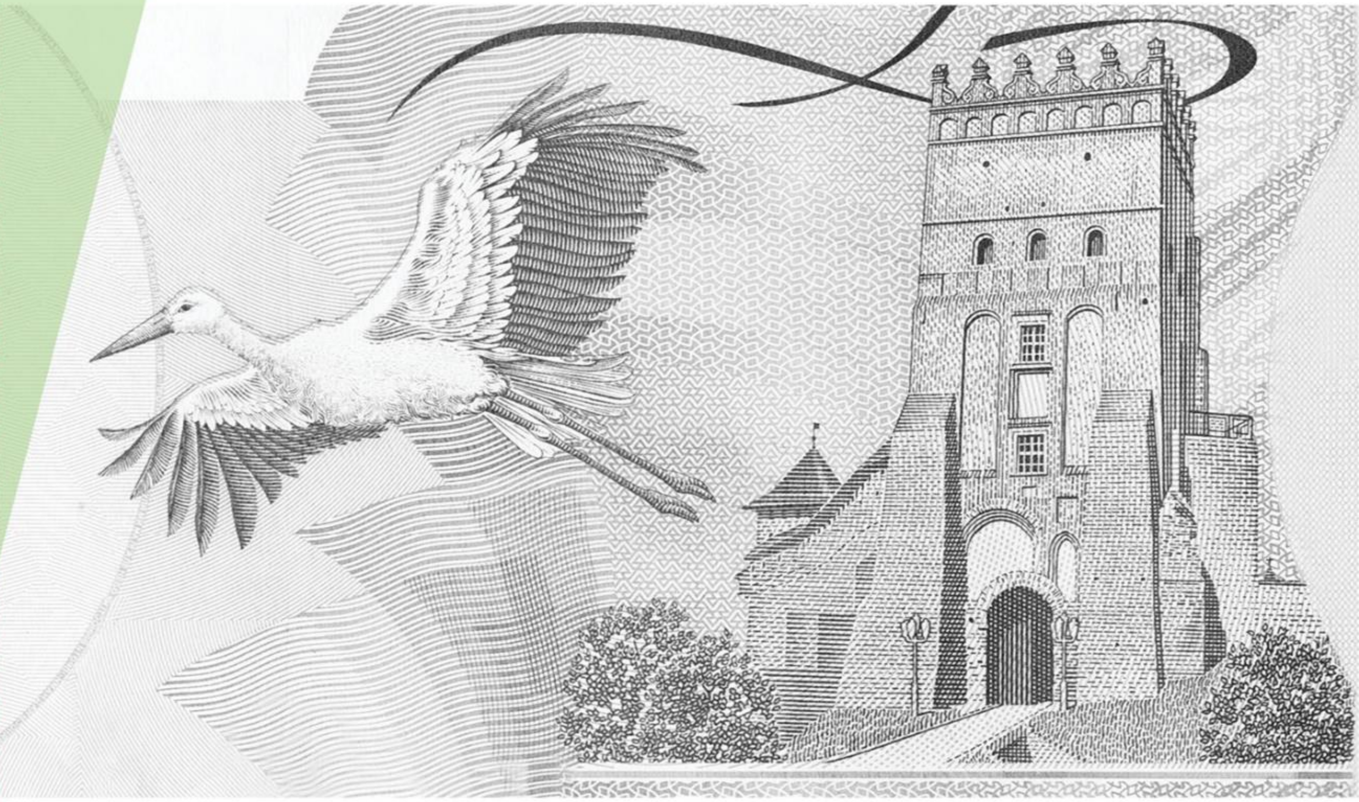
National Bank of Ukraine

Macroeconomic and Monetary Review

March 2021



Summary

External Environment

As economic activity is recovering, global commodity prices remained high in March 2021. With OPEC+ production limits remaining in place, Saudi Arabia making additional above-quota cuts, and the economic outlook in the U.S. and China improving, oil prices rose to USD 70 per barrel in the first half of March. Prices subsequently adjusted downwards on fears that the growth in demand would slow after some EU countries imposed or reimposed lockdowns. Natural gas became more expensive due to strong demand from Asian countries and the Norwegian pipeline repairs. Steel and iron ore prices plateaued at high levels as significant demand was offset by rising supply. Corn prices showed similar dynamics, as high global demand from recovering livestock farming and the imposition of export tariffs by Russia were balanced out by improved USDA estimates of global stocks and expectations for a second harvest in Latin America. Meanwhile, wheat prices fell amid a higher supply from Australia, expectations for a bumper harvest in India, and improved condition of winter crops in the U.S. and the Black Sea region.

In the global financial markets, investor interest in EM assets weakened due to the rapidly rising U.S. Treasury yields. This increase was driven by the Fed maintaining a loose monetary policy despite an anticipated pickup in inflation, and by the introduction of USD 1.9 trillion in additional fiscal stimulus. As the U.S. dollar strengthened, most EM currencies depreciated against it.

Inflation

In February 2021, consumer inflation accelerated to 7.5% yoy (up from 6.1% yoy in January), remaining above the upper bound of its 5% ± 1 pp target range. Core inflation sped to 5.6% yoy (up from 5% yoy in January). Inflationary pressures were generated by the rise in prices for certain foods and fuels. Food prices continued to grow due to last year's lower yields of certain crops in Ukraine and the world, production cutbacks, and higher production costs. Driven by rising global oil prices and sustained strong demand from households, fuel prices returned to growth in year-on-year terms. However, inflation was constrained by the introduction of a price ceiling for natural gas.

The growth in producer prices accelerated sharply in February (to 26.6% yoy), fueled primarily by higher energy and electricity prices and robust demand for metals-and-mining goods (steel, iron ore, coal).

Economic Activity

The IKSO extended its decrease (to 4.3% yoy) in February despite the recovery in economic activity and consumer demand after the January lockdown was lifted. A deeper decline in the Index primarily reflected a calendar effect. Specifically, with retailers returning to business as usual, pent-up demand being met, and consumer sentiment growing more upbeat amid further wage growth, the growth in retail trade turnover accelerated (to 5.6% yoy). However, this did not make up for the setbacks in other sectors. In particular, the decline in agriculture deepened (to 6.5% yoy) due to animal disease outbreaks in some regions, export restrictions, and higher production costs. Industrial output fell more quickly (down 4.6% yoy). As before, the main negative contributors were a difficult situation in the energy sector, the effects of last year’s lower crop yields, and the decline in animal farming (which primarily affected the food industry). A drop in gas transit led to a lower cargo turnover. Poor weather also played a role, affecting performance of cargo turnover, trade, and construction, among other things.

Labor Market

Labor supply and demand revived in February after the January lockdown ended. Nominal wage growth accelerated somewhat (to 15.7% yoy) following the January lockdown, but slowed in real terms (to 7.6% yoy) due to higher inflation.

Fiscal Sector

In February, the state budget deficit widened (to UAH 14.9 billion) as a result of a material acceleration in expenditure growth (to 18.2% yoy). Spending on healthcare and social protection increased (the latter due to higher subsidies for housing and communal services). At the same time, revenues grew relatively moderately (by 7.7% yoy). This increase was underpinned by higher nominal wages and a weaker hryvnia compared to last year. However, the growth in revenues was restrained by cooling economic activity at the beginning of the year and higher VAT refunds than in February of last year. As in January, the budget deficit and debt repayments were financed by domestic borrowings, primarily those denominated in the hryvnia, and previously accumulated foreign currency funds. As is customary for the early months of the year, local budgets ran a surplus (UAH 4.9 billion). With the state budget deficit being large, however, the consolidated budget registered a significant deficit.

Balance of Payments

The current account stayed in surplus (USD 0.5 billion) in February. Exports of goods returned to growth (13.2% yoy), propelled by further increase in global prices and a certain recovery in supplies compared to the previous month. Specifically, the value of exports of grains and metallurgical products increased, while iron ore exports reached an all-time high. At the same time, the growth in imports accelerated (to 5% yoy). The economic recovery since the January lockdown primarily spurred a revival in nonenergy imports, such as machinery, especially vehicles, and also foods and industrial goods. As a result, the trade deficit in goods widened slightly from January, but remained significantly lower than a year ago. Compared to January, repatriation of dividends increased, but was offset by the formation of negative reinvested earnings.

The financial account continued to record capital outflows (USD 0.5 billion), which were generated by the private sector. In particular, negative reinvested earnings led to FDI outflows. The public sector, however, generated capital inflows, albeit somewhat lower than in the previous month, thanks to nonresident interest in domestic government debt securities. As a result, the overall balance of payments came close to zero, but because of repayments to the IMF, gross international reserves decreased slightly, to USD 28.5 billion, covering 4.6 months of future imports.

Monetary Conditions and Financial Markets

In March, the NBU Board decided to raise the key policy rate by 50 bp, to 6.5%. This decision aims to stabilize expectations and gradually bring inflation back to its target, as the Ukrainian and global economies are recovering. At the same time, the key policy rate remained below its neutral level.

Interbank market interest rates continued to closely correlate with movements in the key policy rate, while the still significant liquidity surplus kept the UONIA at the lower bound of the NBU's interest rate corridor. Elevated inflation expectations and significant government financing needs pushed the long end of the yield curve up. Meanwhile, its short end shifted lower, compared to where it started the year, amid significant demand and the government's cap on the supply of short-term hryvnia domestic government debt securities. The weighted average interest rates on most hryvnia loan and deposit transactions by banks continued to decline in February. Hryvnia deposits continued to grow rapidly, while lending activity remained weak.

In March, the FX market was largely balanced. As a result, the official hryvnia exchange rate against the dollar was little changed over the course of the month, with net FX interventions of the NBU close to zero.

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.