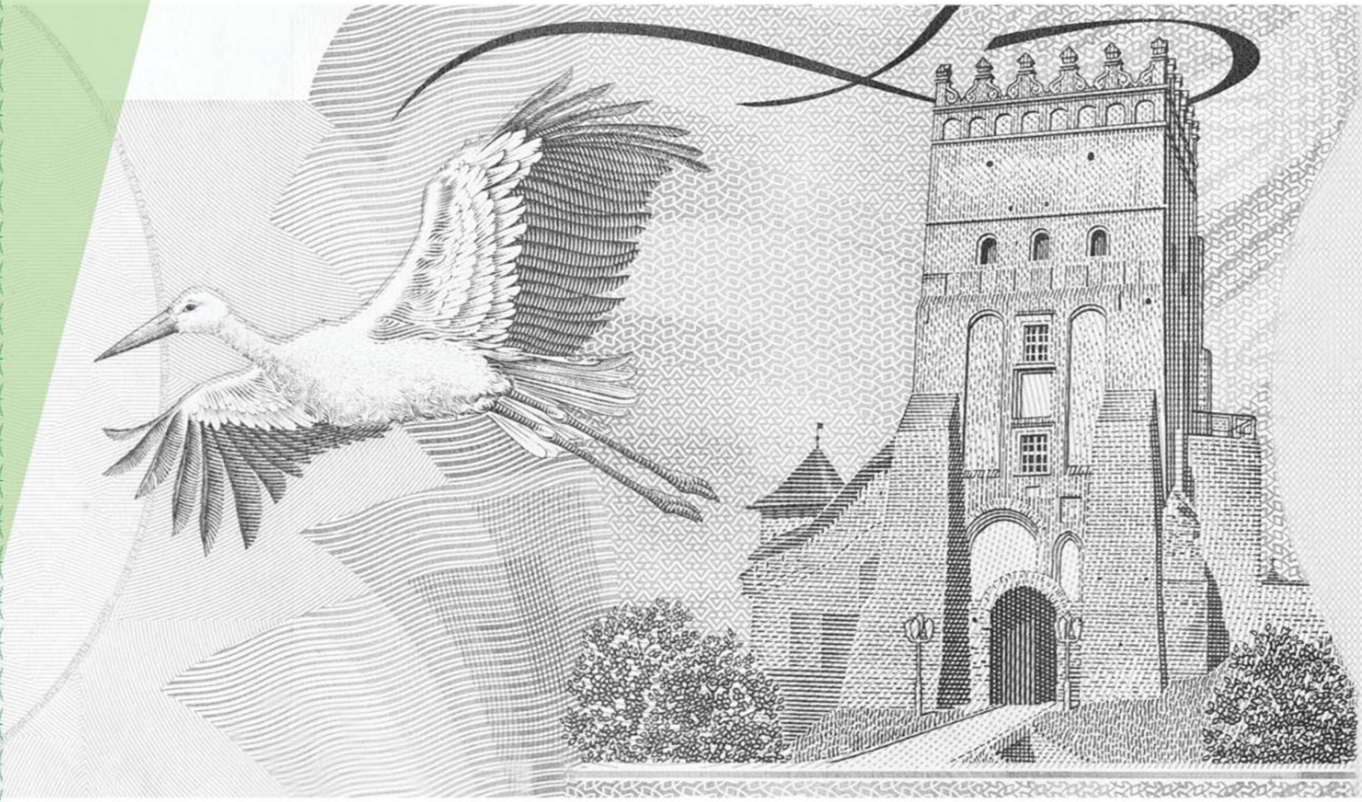
National Bank of Ukraine

Macroeconomic and Monetary Review

April 2021



Summary

External Environment

In April 2021, the global economy continued to recover steadily as vaccination progressed. This underpinned the growth in oil prices against the backdrop of existing production caps by OPEC+ and additional cuts by Saudi Arabia. However, prices adjusted downward amid fears that demand may weaken due to new outbreaks of the pandemic (in India, Japan, etc.). Natural gas rose in price because of declining reserves and colder-than-usual weather in Europe. Steel and iron ore prices rose due to robust demand in most parts of the world and a relatively limited ore supply (including because of logistical hurdles with shipments from Brazil). Adverse weather conditions were also a strong factor in driving grain prices up. Upbeat macroeconomic data from leading countries, better-than-expected quarterly earnings reports, and declining yields on U.S. Treasuries boosted investor interest in risky assets. This resulted in most EM currencies strengthening against the U.S. dollar, which depreciated against a basket of major world currencies.

Inflation

In March 2021, consumer inflation accelerated to 8.5% yoy (up from 7.5% yoy in February), remaining above the upper bound of its 5% ± 1 pp target range. As in previous months, pressure from food prices increased due to the reduced supply of livestock products and high global prices for foods (sunflower oil, grains). The annual growth of fuel prices accelerated, driven by rising global oil prices and sustained strong demand from households. Core inflation also accelerated to 5.9% yoy (up from 5.6% yoy in February). The increase in underlying inflationary pressures was due to both supply factors and steady consumer demand.

The growth in producer prices in March remained practically unchanged, at 26.3% yoy. Metals-and-mining products grew more expensive, as did energy and food products, but these increases were offset by lower prices in electricity generation.

Economic Activity

In March, despite the imposition of tight quarantine measures in a number of regions, the decline in the IKSO (amounted to 0.1% yoy) almost stopped. The revival in consumer demand was reflected in a sharply accelerated increase in retail trade turnover (to 13.1% yoy) against the backdrop of faster growth in wages and pensions. The low base of comparison, due to the tougher lockdown last year, also played a role. The same factor underpinned the recovery in passenger turnover growth. Industrial production also returned to growth (by 2.1% yoy). Strong demand for ores, coupled with the removal of coal supply holdups, supported the mining sector. The increase in the volume of TPP generation and the recommissioning of NPP units following repairs led to a rapid output increase in the energy sector. Growth resumed in most sectors of manufacturing amid favorable external conditions and strengthening domestic demand. The decline in agriculture slowed (to 2.3% yoy) thanks to improved poultry performance. With improved meteorological conditions and an increase in budget expenditures on road infrastructure, the decline in construction decelerated (to 11.5% yoy). A rise in exports and industrial production bolstered freight turnover (slowing its decline to 7.4% yoy).

Labor Market

In March–April, labor demand continued to grow, despite the imposition of quarantine in “red zones” in a number of regions. However, the further spread of COVID-19 subdued job-seeking efforts both in Ukraine and abroad. The growth in nominal and real wages accelerated rapidly (to 18.9% yoy and 9.5% yoy, respectively), largely due to the low base of comparison.

Fiscal Sector

In March, the state budget deficit narrowed (to UAH 4.8 billion), primarily due to a significant acceleration in revenue growth (to 22.4% yoy). This was facilitated by an increase in nominal wages, better financial performance of businesses, and a further recovery in domestic demand, including for imported goods. Healthcare spending kept growing at a fast pace. Expenditures on defense and economic activity increased, especially as spending on road infrastructure picked up. However, the overall growth in spending decelerated (to 12.0% yoy), in part due to the impact of a higher base of comparison for some social expenditures. As expected, the budget deficit and debt repayments were financed by domestic borrowing and previously accumulated foreign currency. Despite the surplus in local budgets (UAH 1.7 billion), the consolidated budget ran a deficit.

Balance of Payments

After a significant surplus in January–February, the current account balance went back into deficit in March (USD 0.1 billion). This was due to the widening trade deficit and scheduled interest payments on restructured Eurobonds. Growth in both exports (24.8% yoy) and imports (26.7%) accelerated, but the latter grew faster, driven by pent-up consumer and investment demand. Specifically, nonenergy imports increased significantly for all groups of goods, especially machinery products. Imports of energy also rose noticeably because of ramped up purchases of petroleum products and coal. The growth in exports was driven primarily by a significant increase in sales of metallurgical products as both volumes and prices rose. The price factor also helped the value of iron ore exports hit a new all-time high. Export growth was still constrained by intensified competition in the global metals-and-mining market, and the drawdown of agricultural stocks.

The financial account continued to record capital outflows (USD 0.7 billion). This was primarily due to a souring of global financial conditions for EMs in March. Net nonresident investment inflows into hryvnia domestic government debt securities narrowed to USD 97 million. In addition, the government made scheduled repayments on external public debt. FDI outflows also continued. The balance of payments deficit, coupled with repayments to the IMF, led to a decline in international reserves (to USD 27 billion, covering 4.1 months of future imports).

Monetary Conditions and Financial Markets

In April, the NBU Board raised the key policy rate by 100 bp, to 7.5%. The move was a response to strengthening underlying inflationary pressures, aimed at returning inflation in to its 5% target yet in H1 2022.

Interbank market interest rates, which closely correlate with the key policy rate, increased. The sustained large liquidity surplus kept the UONIA almost at the lower bound of the NBU's interest rate corridor. Yields on hryvnia domestic government debt securities also inched higher amid investors' elevated perceptions of risk, given the threat posed by Russia's heavier military presence in the occupied territories and along Ukraine's borders. These same factors exerted depreciation pressure on the hryvnia during most of April. At the same time, with external price conditions being favorable, and Russia having partially pulled out its troops, the hryvnia went back to strengthening later in the month. The NBU's FX interventions were close to zero.

In March, hryvnia rates on most customer transactions in banks (except for retail deposit rates, which continued to decrease) stopped declining. Hryvnia deposits continued to grow rapidly, while lending to households picked up.

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.