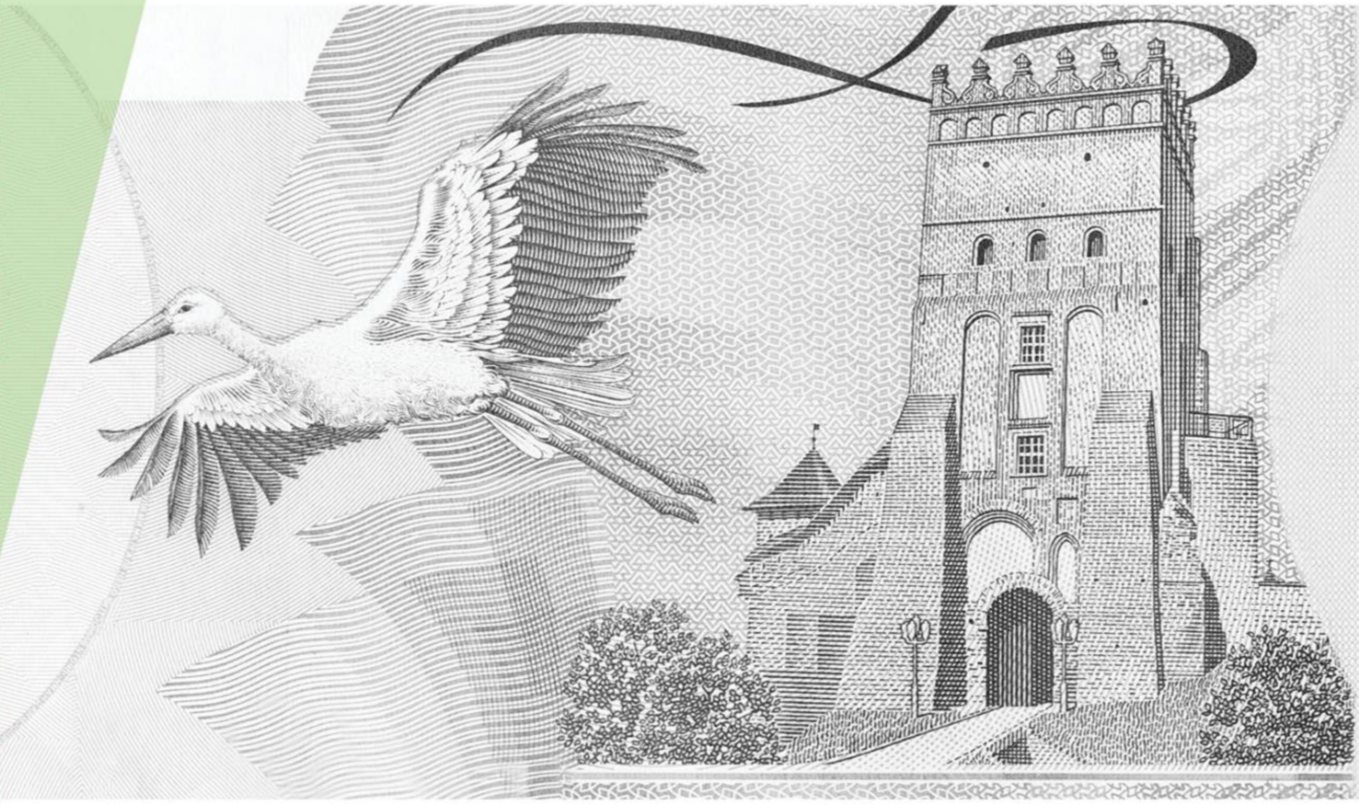
National Bank
of Ukraine

Macroeconomic and Monetary Review

May 2021



Summary

External Environment

In May 2021, the global economy recovered steadily as vaccination progressed despite the spread of new strains of Covid-19 in some Asian countries, including India. Coupled with a surge in hydrocarbon prices due to tighter regulations for carbon emissions in the EU and the drawdown of reserves, this pushed natural gas prices higher. At the same time, oil prices stabilized at about USD 68 per barrel as the increase in U.S. and Russian production offset production cuts by OPEC countries and fully met the gradually growing demand. The rise in steel and iron ore prices accelerated amid a significant shortage in the market even as production increased. At the end of the month, however, prices for these goods declined, due to tighter regulatory oversight over price-setting behavior in China. Grain prices decreased thanks to improved crop conditions in North America and the Black Sea region and expectations for bumper harvests during the next marketing year. Meanwhile solid demand from livestock and bioethanol producers, and a poorer second harvest in Brazil after the country was hit by a drought supported maize prices. Global stock markets performed slightly worse, reacting to the Fed’s ambiguous signals regarding potential adjustments to its asset purchases. Amid a weaker U.S. dollar to a basket of currencies, this resulted in most EM currencies strengthening against the U.S. dollar.

Inflation

In April 2021, consumer inflation decelerated slightly to 8.4% yoy (down from 8.5% yoy in March), but remained above the upper bound of its 5% ± 1 pp target range. The main reason for this decrease was a slower rise in raw food prices. Specifically, the fall in the prices of borshch vegetables deepened amid significant stocks left over from last year, while prices for citrus fruits declined because of lower external prices. At the same time, underlying inflationary pressures intensified due to sustained consumer demand and higher production costs, speeding up core inflation to 6.3% yoy (from 5.9% yoy in March). Fuel prices also continued to accelerate amid strong demand from households and rising global oil prices.

Price increases for industrial products accelerated (to 27.8% yoy in April), driven by rising prices for iron ore and energy resources as global commodity prices trended higher.

Economic Activity

The growth in the IKSO accelerated to 18.3% yoy in April. A major driver of this increase was the comparison base effect: in April of last year, the Ukrainian authorities imposed a strict lockdown, as did governments in most countries, depressing domestic and external demand. However, economic activity continued to recover even without accounting for the comparison base effect, as this year restrictions were less strict than a year ago, they were put in place in selected regions (designated as “red zones”), and households and businesses adjusted to the Covid-19 reality. Favorable external conditions were an additional driver of growth. Retail trade growth accelerated rapidly to 34.3% yoy, while passenger turnover increased significantly. The growth in industrial production also sped up (to 13.0% yoy). The manufacturing industry grew due to the recovery of the sectors with a focus on domestic consumers (textiles, furniture production, etc.) and investment demand (machinery), and because of higher exports of metallurgy products and chemicals. Accordingly, performance in sectors that represent links in the chain of production improved: strong demand for coal and ore placed the mining industry back on the growth track. Spurred by an increase in budget expenditures on road infrastructure and by the public’s demand for housing, construction returned to growth (by 12.9% yoy). The recovery of industry and construction fueled the growth in freight turnover and wholesale trade. Agricultural output continued to decline (by 4.6% yoy) amid rising production costs.

Labor Market

Labor demand and supply began to grow fast after the May holidays and the easing of quarantine measures. The growth in nominal and real wages accelerated rapidly (to 29.8% yoy and 19.7% yoy, respectively), primarily due to the low base of comparison, supplementary payments to healthcare workers, and recovering economic activity.

Fiscal Sector

The state budget recorded a UAH 3.7 billion deficit in April due to a notable slowdown in revenue growth (to 1.4% yoy). This was due to lower transfers by the NBU of last year's distributable profit (UAH 24.4 billion), which is part of nontax revenues. Meanwhile, tax revenues increased due to recovering economic activity and low comparison base. Expenditure growth accelerated somewhat (to 13.5% yoy). Funding for defense and road infrastructure continued to grow, the government was catching up on the backlog of expenditures on humanitarian purposes, including education. Spending on healthcare and social protection remained a priority. Local budgets recorded a surplus (UAH 1.9 billion) in April, but the consolidated budget remained in deficit.

Balance of Payments

In April, the current account moved back into surplus (USD 0.8 billion) due to a significant narrowing of the merchandise trade deficit. As a result of tighter quarantine restrictions in some regions of Ukraine, imports of goods declined in April compared to March, with the largest decreases occurring in purchases of machinery, food, and industrial goods. However, the growth in imports was significant (53.6% yoy) due to last year's low comparison base. Exports of goods remained at March levels. Their growth in annual terms (34.8%) was underpinned by a further rise in the global food prices (grains, oilseeds, vegetable oil, chicken meat) and metals-and-mining products. As before, export growth was restrained by low stocks of agricultural products and tighter competition in the global markets.

Capital outflows from the financial account nearly stalled (USD 43 million). Specifically, as financial conditions for EMs improved, Ukraine returned to the international capital markets by placing USD 1.25 billion of Eurobonds. However, public sector revenues were offset by capital outflows from the private sector due to repayments of trade credits and negative reinvested earnings due to significant dividend payouts. With the current account surplus being significant, the balance of payments registered a surplus (USD 0.8 billion), while international reserves increased to USD 28 billion, covering 4.3 months of future imports.

Monetary Conditions and Financial Markets

The UONIA, a reference interest rate on the interbank lending market, hovered around the lower bound of the NBU's interest rate corridor in May due to a significant liquidity surplus at banks. The yields on hryvnia domestic government debt securities remained virtually unchanged in May after rising in April.

Interest rates on loans and deposits for nonfinancial corporations inched higher in April in response to a key policy rate hike. At the same time, interest rates on retail term deposits continued to creep down. While deposit inflows to banks from households continued, they preferred demand deposits. As a result, weighted average rates on retail deposits kept on declining. Lending also recovered further.

FX market supply surpassed demand in May, driven by favorable external price conditions and quarterly tax payments. The official UAH/USD exchange rate strengthened by 0.9% in May. The NBU did not intervene in the FX market.

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.