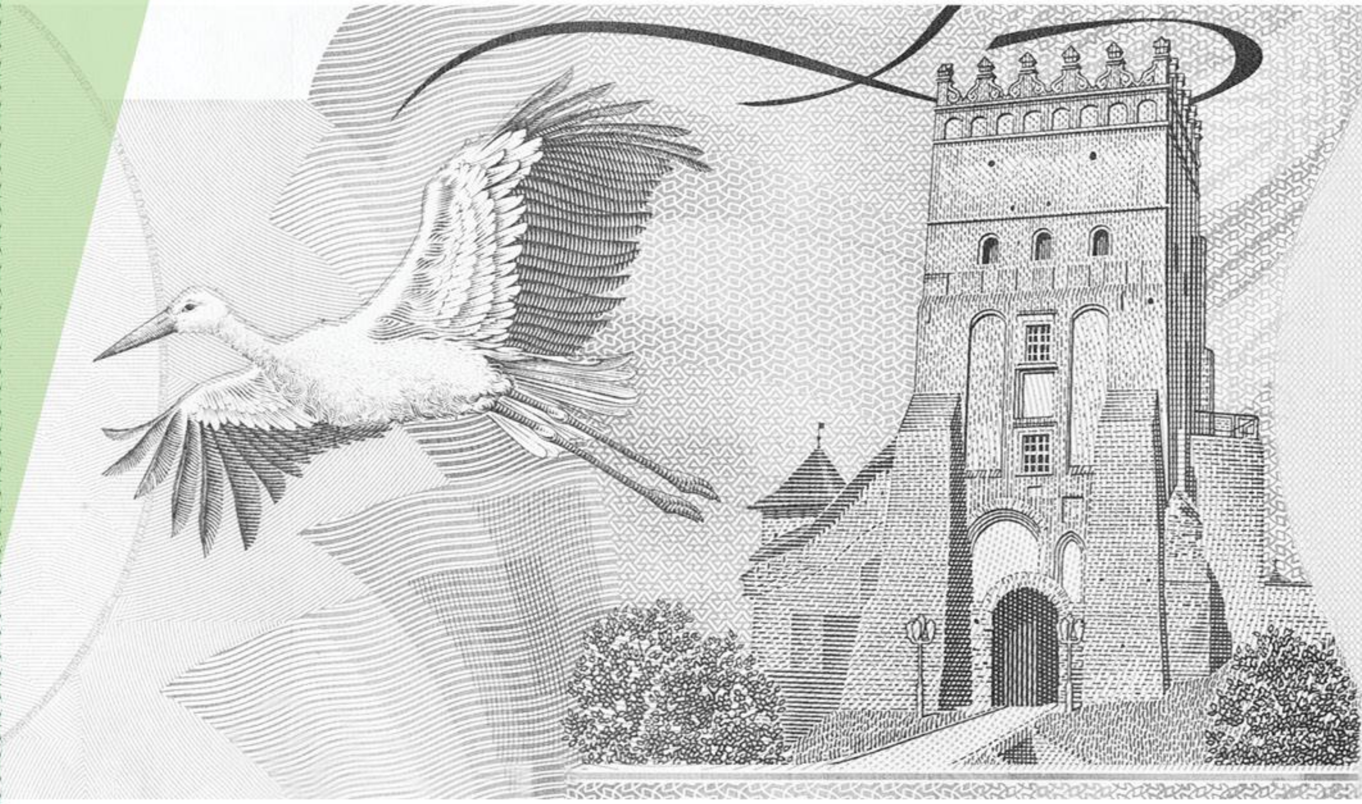
National Bank of Ukraine

Macroeconomic and Monetary Review

June 2021



Summary

External Environment

In June 2021, the global economic recovery continued at a steady pace due to upbeat business sentiment as vaccination progressed, despite the emergence of new strains of the coronavirus. Coupled with a seasonal increase in mobility in the U.S. and the EU, this drove up oil prices to more than USD 75 per barrel. Natural gas rose in price due to an abnormal heat wave in Europe and still relatively low reserves. In contrast, steel prices stabilized: active demand was restrained by the further tightening of the Chinese government's price controls in the metals-and-mining market. Despite the latter, iron ore prices rose after supplies from Rio Tinto (Australia) were disrupted by maintenance work and Vale (Brazil) cut back on production amid the risk of a dam breach. For the first time in several months, grain prices declined in sync. Wheat became cheaper due to the start of the new harvest and expectations of record-high global production volumes. Corn prices fell because of a potential exemption of U.S. oil refineries from biofuel requirements. Volatility in the global financial markets increased after the Fed signaled that it had started contemplating cuts to its asset-purchase program and most FOMC members projected a sooner-than-expected rate hike. At the same time, disagreement among the FOMC members eroded interest in risky assets. With the U.S. dollar strengthening against a basket of major currencies, this made most EM currencies depreciate.

Inflation

In May 2021, consumer inflation accelerated to 9.5% in annual terms (up from 8.4% in April). This was primarily due to price increases for the highly volatile components of the consumer basket, in particular the significantly faster growth in prices for natural gas, sunflower oil, and sunflower oil products (mayonnaise, spreads, etc.). The latter was one of the main reasons that core inflation sped to 6.9% yoy (from 6.3% yoy in April). However, underlying price pressures also continued to intensify, primarily due to sustained consumer demand and higher production costs. This was confirmed by the faster rise in prices for nonfood products and services. Fuel prices continued to climb, driven by higher global oil prices, the effect of a low comparison base, and the persistence of strong demand from households. At the same time, the increase in raw food prices continued to slow, primarily due to significant stocks of vegetables and an ampler supply of both imported and Ukrainian products.

Price increases for industrial products accelerated sharply (to 33.1% yoy in May), mainly fueled by rising prices for energy and metals-and-mining products – such as iron ore and steel – as global prices trended higher.

Economic Activity

The growth in the IKSO slowed in May, to 4.1% yoy, as the comparison base effect faded slightly (last year, it was in May that the quarantine restrictions were relaxed and most industries returned to business as usual). In addition, production in the livestock farming and food sectors continued to fall, reflecting the ongoing effect of last year's lower harvests and a deep slump in tobacco output. Energy generation declined. At the same time, economic activity was underpinned by strong consumer demand, a pick-up in investment activity, and favorable external conditions. More specifically, retail trade grew at a high pace (22.7% yoy), while passenger turnover surged. High external demand for ores, as well as increasing coal production, accelerated the growth in mining. The manufacturing sector grew, driven by the sectors aimed at meeting consumer (textiles, furniture, etc.), investment (machinery), and external demand (metallurgy and chemical industry). Overall, industrial growth came in at 5.4% yoy. Against the backdrop of lower budget expenditures on road infrastructure, construction returned to decline (by 8.4% yoy), although residential construction reported a robust increase. The growth in the mining and metallurgical industry and larger deliveries of construction materials contributed to an increase in freight turnover. In contrast, lower grain exports, coupled with a decrease in imports of petroleum products amid disruptions in supplies from Russia and Belarus, led to a decline in wholesale trade.

Labor Market

Labor demand continued to grow, while supply remained subdued, in part due to the start of the holiday season and the extended June weekends. Nominal and real wages kept rising at a high rate (28.1% yoy and 16.8% yoy in May, respectively), primarily due to the resumption of economic activity, the sustained effects of a low comparison base, and Covid-19 relief paychecks to healthcare professionals.

Fiscal Sector

In May, the state budget ran a deficit (UAH 4.6 billion) as a result of a marked acceleration in expenditure growth (to 26.4% yoy). Expenditures on healthcare (including vaccination) and social protection (such as one-off Covid-19 relief payments) increased at a faster pace. Other expenditures grew more slowly than in April. Revenues also increased sharply in May (to 61.7% yoy). This growth was primarily fueled by fundamental economic drivers, such as sustained consumer demand, higher nominal wages, the improved financial performance of businesses, and high prices for certain natural resources. An additional factor was that the transfer of dividends by state-owned companies to the budget occurred earlier than it did last year (especially the first installment, of UAH 10 billion, from CB PrivatBank JSC). Local budgets in May recorded a significant surplus (UAH 7.8 billion), which translated to a surplus in the consolidated budget.

Balance of Payments

In January, the current account surplus widened (to USD 0.7 billion) compared to April. The surplus of trade in goods outweighed the increase in the repatriation of dividends. Specifically, further growth in global prices and the dynamic recovery of the world economy contributed to the acceleration of growth in goods exports (61.7% yoy and 2.3% yoy). It primarily affected the exports of metals-and-mining products, while the growth in food exports was still restrained by last year's poorer harvest of major crops. Compared to April, imports of goods declined by 1.2% sa due to the energy component. In annual terms, however, these imports grew at a record pace (52.6%) because of the low base of comparison. Thus, the reduction in natural gas purchases due to high global prices and disruptions in oil supplies from Russia and Belarus offset the effect of higher energy prices. At the same time, sustained domestic demand continued to underpin high volumes of purchases of nonenergy goods, both consumer and investment.

Capital outflows from the financial account resumed (USD 1 billion). These were generated by the private sector. Specifically, the banks increased their assets, in particular due to government redemption of FX domestic government debt securities. Real sector outflows were mainly generated by the growth in nonresident debt on trade loans, primarily for Ukraine's exports of goods, and a decline in similar liabilities of resident companies. FDI inflows were modest due to repayments on direct investor loans. As a result, the overall balance of payments recorded a small deficit (USD 0.3 billion). International reserves decreased slightly, to USD 27.8 billion, covering 4.2 months of future imports.

Monetary Conditions and Financial Markets

In June, the NBU left its key policy rate unchanged, at 7.5% per annum. This decision was informed by the fact that the inflation acceleration in May was largely driven by supply factors that were mainly short-term in nature. The sustained large liquidity surplus kept the UONIA almost at the level of the NBU's interest rate corridor's lower bound. Renewed foreign investors interest in hryvnia domestic government debt securities balanced out significant repayments on government securities. At the same time, the yield on hryvnia domestic government debt securities in the primary market was almost unchanged, while in the secondary market it inched lower.

In May, banks gradually raised hryvnia rates on their products in response to the NBU's previous key policy rate hikes. However, some rates, particularly those on demand deposits, reacted only marginally amid a significant inflow of these funds into the banking system.

For most of June, supply prevailed in the FX market, thanks to favorable external price conditions and rekindled nonresident interest in hryvnia domestic government debt securities. At the end of the month, however, ad-hoc factors (significant budget spending, elevated volatility in the global financial markets) strengthened FX demand, making the hryvnia weaker. To smooth out excessive exchange rate fluctuations, the NBU intervened by both purchasing and selling foreign currency in June. As a result, the regulator generated USD 0.6 billion in net FX purchases.

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.