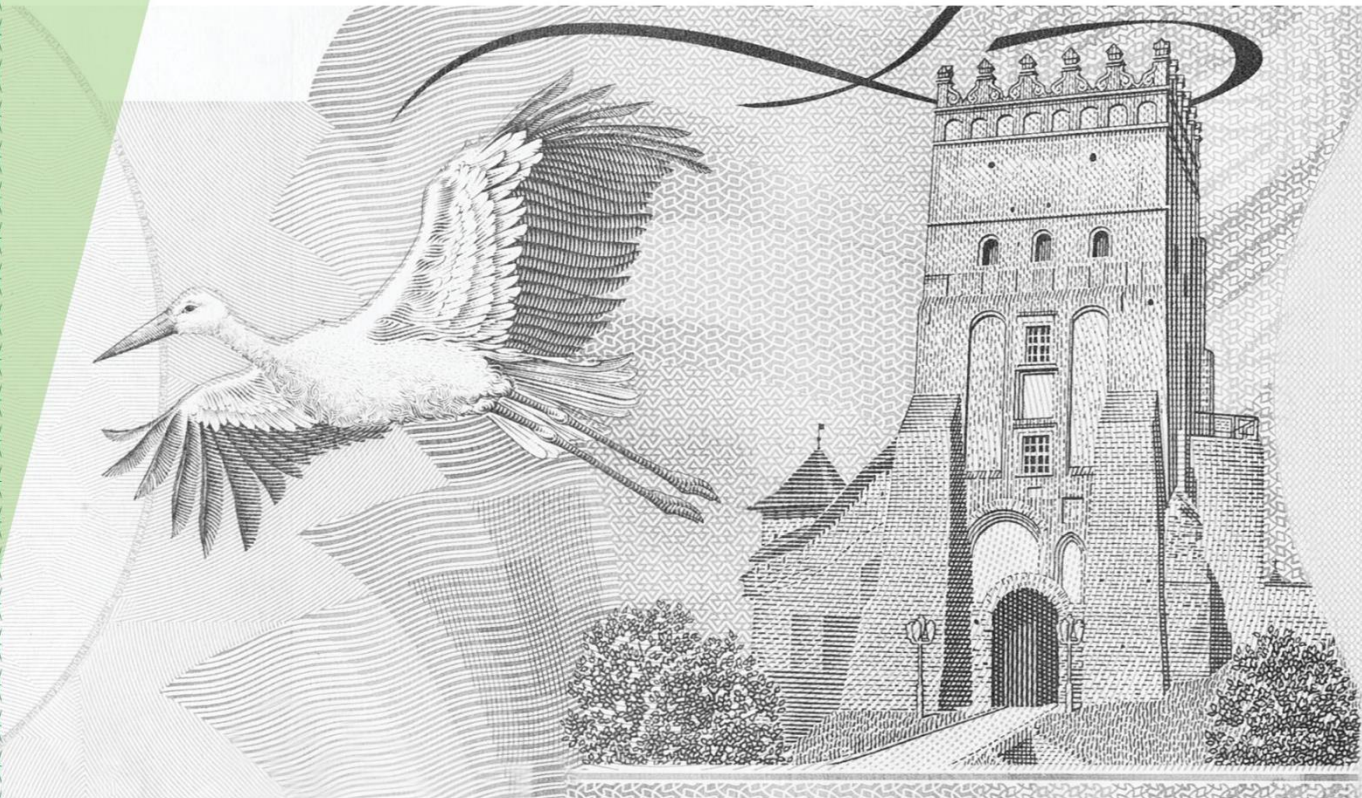




National Bank
of Ukraine

Macroeconomic and Monetary Review

July 2021



Summary

External Environment

In July 2021, the divergence between growth rates in developed and EM countries widened as new variants of Covid-19 spread across the globe and some countries lagged behind on vaccination. As a result, expectations for global oil demand soured. Coupled with the OPEC+ deal to ramp up production, this drove oil prices lower. In contrast, natural gas prices in Europe rose sharply due to limited supplies from Norway, low reserves and strong demand. Steel climbed in price amid tighter production restrictions in China as part of its push to green its economy and due to supply chain disruptions in Germany as it came under heavy rain. Iron ore prices fluctuated within narrow limits, staying at a high level: significant global demand offset a gradual increase in supply from Brazil, Australia, and India. Deteriorating weather conditions put upward pressure on grain prices, including those for wheat. However, declining biofuel production in the U.S. and Brazil dampened the increase in corn prices. Appetite for EM assets in the global financial markets weakened due to the slower pace of economic recovery in EM countries. The plunge in Chinese shares in late July, due to stricter government regulations imposed on tech companies and the education sector, was an additional factor. However, no new signals that the Fed might withdraw monetary stimulus coupled with weaker-than-expected macroeconomic data in the U.S. weakened the U.S. dollar, leaving most EM currencies stronger.

Inflation

In June 2021, consumer inflation was flat from the previous month in annual terms, at 9.5%. On the one hand, the growth in raw food prices decelerated as supply expanded. Fuel prices also grew more slowly, primarily due to the fading of the low comparison base effect. Natural gas prices, on the other hand, continued to rise. Core inflation accelerated to 7.3% yoy (up from 6.9% yoy in May) due to a further increase in sunflower oil prices, higher production costs of businesses, and sustained consumer demand.

The growth in the prices of industrial products sped up in June (to 39.1% yoy). This was mainly fueled by higher prices for energy, metals-and-mining products (iron ore and steel), and some other inputs amid similar developments in the global markets.

Economic Activity

As expected, the growth in the IKSO slowed to 1.7% yoy in June, in part due to the fading of the comparison base effect. In addition, the decline in agriculture deepened (to 16.3% yoy), as harvesting got off to a late start. Industry grew more slowly (by 1.1% yoy) as the food and energy sectors slumped. More specifically, sunflower oil production continued to decline due to last year's poor harvests and because of weaker external demand for this crop. The output of tobacco products also fell amid the waning popularity of traditional tobacco products. With weather in June being relatively cooler, the manufacture of beverages also dropped. Cold weather also contributed to deeper decrease in output in the energy sector. However, economic activity continued to be underpinned by consumer demand (retail trade and passenger turnover grew strongly), favorable external conditions (particularly for metallurgy), and an increase in public spending on infrastructure projects (construction rose by 21.0% yoy). In a sign of a revival in investment demand, the manufacture of some types of machinery grew at a high pace. Growth in metallurgy and construction supported freight turnover.

Labor Market

Nominal and real wages continued to grow fast, gaining 23.6% yoy and 12.9% yoy, respectively. The fading of the low comparison base effect was partially offset by higher holiday pay in the public sector due to the minimum wage increases in September 2020 and January 2021 and the increase in educators' wages at the start of this year.

Fiscal Sector

The state budget deficit widened (to UAH 9.5 billion) in June as expenditures grew (by 26% yoy) and revenues fell (by 11.7% yoy). Revenues declined due to smaller dividend transfers to the state budget by state-owned companies. Meanwhile, tax revenues continued to grow, driven by sustained consumer demand, higher nominal wages, and high prices for natural resources. Expenditures increased, fueled mainly by road infrastructure and education spending, and inter-budgetary transfers. As expected, local budgets ran a deficit (UAH 0.2 billion) in June. As a result, the consolidated budget recorded a deficit.

Balance of Payments

The current account continued to run a surplus in June, but it narrowed from previous months (to USD 0.3 billion) as the trade in goods moved back into deficit. More specifically, the [weakening of global demand for sunflower oil](#) led to a decrease in total exports of goods compared to May. In contrast, imports of goods increased due to purchases of machinery products and a further increase in energy prices. Financial account capital inflows (USD 0.5 billion) were driven by public sector borrowings, including net purchases of hryvnia domestic government debt securities by nonresidents and an [IBRD loan](#). Private sector capital outflows declined after a [Eurobond placement by Ukravtodor](#) partially offset further repayments on trade loans. As a result, the consolidated balance of payments ran a surplus (USD 0.8 billion), and international reserves increased to USD 28.4 billion, covering four months of future imports.

Monetary Conditions and Financial Markets

In July, the NBU [raised its key policy rate](#) by 0.5 pp to 8.0% and took additional measures to tighten its monetary policy. These steps are intended to ease inflationary pressures and keep inflation expectations in check. The [UONIA](#), an interbank overnight interest rate index, increased, but continued to hover around the lower bound of the NBU's interest rate corridor amid a significant liquidity surplus in the banking system. At the same time, the yield on hryvnia domestic government debt securities remained virtually unchanged. In June, banks slightly raised the rates on some of their loan products in response to previous key policy rate hikes. Deposit rates remained stuck amid abundant liquidity.

In July, the FX market was dominated by appreciation pressure on the hryvnia due to an ample supply of FX cash and FX sales by banks from their currency positions. The official exchange rate of the hryvnia against the dollar strengthened by 1.0%. The NBU's net FX purchases amounted to USD 0.1 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.