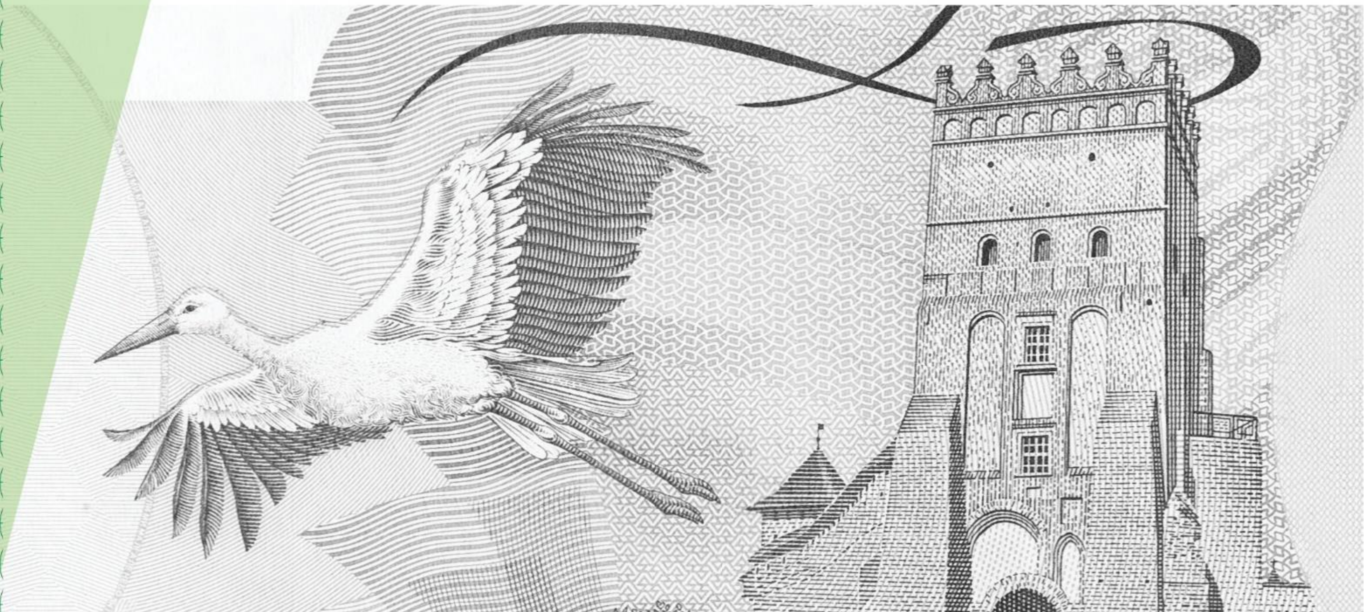
National Bank of Ukraine

# Macroeconomic and Monetary Review

August 2021



# Summary

### External Environment

In August 2021, the spread of new strains of the coronavirus throughout the world prompted some countries to tighten their quarantine measures, which became a drag on the economic rebound, especially in EMs. As a result, demand for oil weakened somewhat. With the U.S. calling on OPEC+ to ramp up production, this pushed oil prices lower. In contrast, natural gas continued to rise in price amid the still low reserves and a surge in demand fueled by abnormally hot weather. Steel and iron ore prices declined, primarily due to weaker demand from China as its industrial and construction growth decelerated. Grain prices showed mixed dynamics, with wheat growing more expensive while corn prices fell. This was due to a change in crop expectations as weather conditions turned unfavorable for wheat and improved for corn. Investor appetite for risky assets waned, reflecting a slowdown in the EM recovery and the expected rollback of monetary stimulus by the Fed this year. Coupled with the strengthening of the U.S. dollar against a basket of major currencies, this left most EM currencies weaker.

### Inflation

In July 2021, consumer inflation accelerated to 10.2% yoy, driven primarily by higher food prices, in particular vegetables. This, in turn, was due to unfavorable weather for some vegetables, as well as heightened pressure from production costs and consumer demand. At the same time, the growth in the price of natural gas and fuel slowed. Core inflation remained at the previous month's level of 7.3% yoy. Increased pressure from production costs and consumer demand was offset by the slower growth in sunflower oil and non-food prices, which was partly due to favorable FX market conditions.

Price increases for industrial products accelerated further, to 42.2% yoy, reflecting the persistence of high global prices for energy and metals and higher production costs.

### Economic Activity

In July, IKSO growth accelerated to 2.3% yoy. Economic activity picked up, driven primarily by agriculture, which returned to growth (9.2% yoy) as the harvest pace accelerated amid higher than last year's crop yields. Driven by hot weather, energy generation returned to growth. Overall, however, the volume of industrial production remained at last year's level (up by 0.2% yoy). Although external conditions were favorable for metal ore mining and metallurgy, last year's low harvest continued to affect the food sector and wholesale trade, while the reduction in gas transit remains a drag on freight turnover. At the same time, robust consumer demand supported rapid growth in retail trade and passenger turnover. Construction output shrank by 0.5% yoy, dragged down by modest budget funding for road construction and infrastructure projects.

### Labor Market

Wage growth continued to be strong, although it slowed somewhat (to 21.5% yoy in nominal terms as the low comparison base effect faded, and to 10.2% yoy in real terms due to higher inflation). Demand for labor remained strong.

### Fiscal Sector

The state budget remained in deficit (UAH 10.3 billion) in July although expenditures fell (by 0.8% yoy) and revenues increased (by 28.9% yoy). Revenues grew, driven by sustained consumer demand, large imports, higher nominal wages, and high prices for natural resources. The decline in expenditures was largely due to the comparison base effect, given a pick-up in Covid-19 spending in July last year. As expected, local budgets ran a surplus (UAH 6.4 billion) in July. However, the resulting consolidated budget remained in deficit.

### Balance of Payments

The current account deficit widened compared to June, to USD 0.3 billion in July, driven primarily by a further increase in the value of merchandise imports.[1] Specifically, energy imports increased compared to June, propelled by rising energy prices and the gradual resumption of natural gas purchases. Nonenergy imports also grew: robust investment demand fueled an increase in imports of certain machinery products, while imports of chemical products increased due to the purchase of fertilizers and vaccines against COVID-19. Merchandise exports rose, reflecting a further increase in the value of exports of metals-and-

[1]Data for the months of Q2 2021 were updated after reinvested earnings were revised.

mining products amid a surge in global prices. At the same time, delays in the harvesting of new crops and the drawdown of major crop stocks restrained export growth. As a result, the goods trade deficit widened to USD 0.6 billion.

The financial account continued to record capital inflows (USD 0.8 billion). In contrast to previous months, the real sector was responsible for a significant share of these inflows. Specifically, the further improvement in the financial performance of businesses contributed to the growth in reinvested earnings and thus in FDI. In addition, the placement of USD 0.3 billion of Eurobonds by Ukrzaliznytsia generated portfolio investment inflows. Despite the additional Eurobond placement, public sector borrowings declined as nonresident appetite for domestic government debt securities waned. As a result, the consolidated balance of payments ran a surplus, while international reserves increased to USD 29 billion, covering 4.1 months of future imports.

### Monetary Conditions and Financial Markets

In August, the Ukrainian OverNight Index Average UONIA hovered around the lower bound of the NBU's rate corridor amid a sustained significant liquidity surplus in the banking system. The primary market yields on hryvnia domestic government debt securities remained virtually unchanged, except for one-year securities, the rates on which were marginally raised by the Ministry of Finance. In July, banks slightly increased interest rates on loans to nonfinancial corporations. At the same time, the weighted average rates on other hryvnia products lacked a distinct trend.

In August, the FX market was dominated by FX supply, which got a boost from a significant increase in export earnings and quarterly tax payments. The hryvnia came out 1.6% stronger against the U.S. dollar, according to official exchange rate data. The NBU's net FX purchases amounted to USD 0.3 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.*