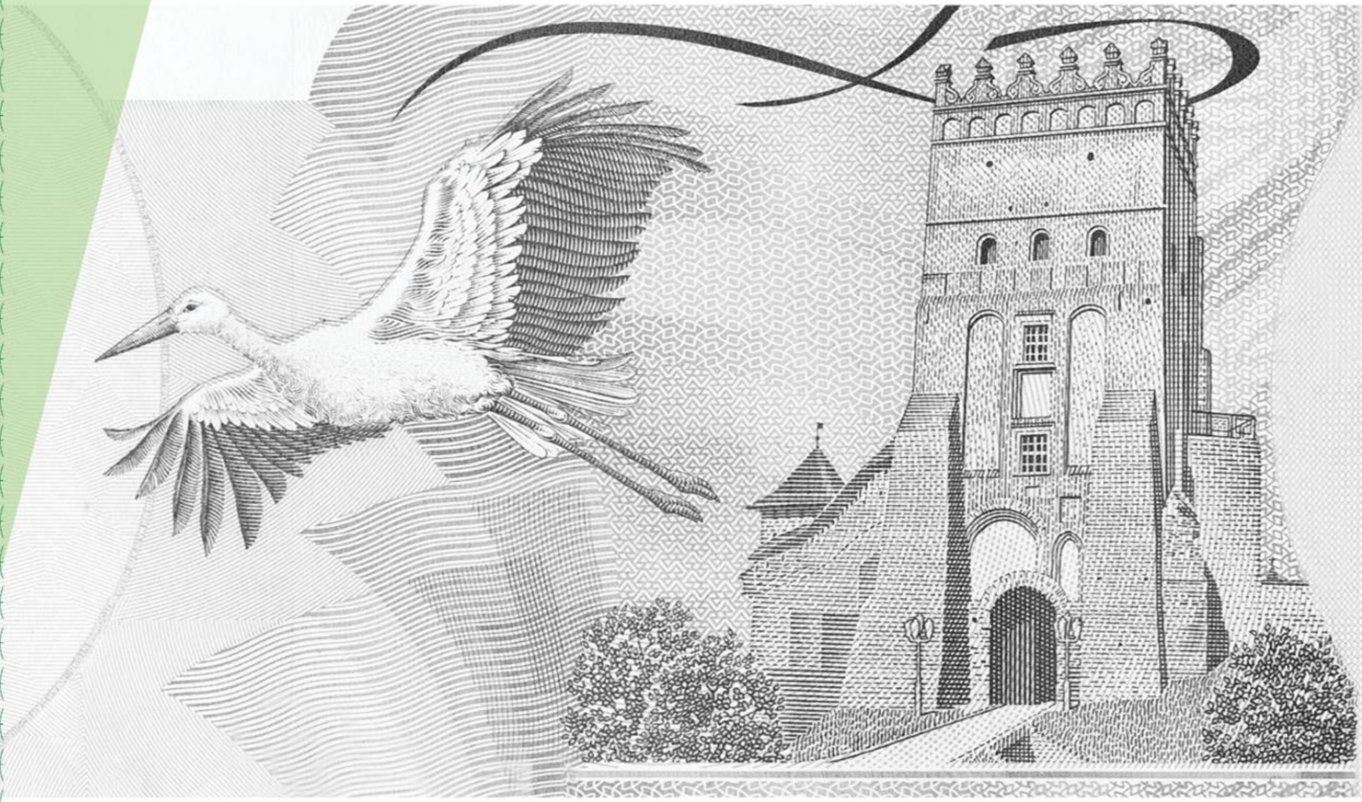
National Bank of Ukraine

Macroeconomic and Monetary Review

September 2021



Summary

External Environment

Leading economic activity indicators signaled the global economic recovery in September 2021 slowed somewhat as some countries tightened their quarantine measures to limit the accelerated spread of COVID-19. Yet, oil rose in price due to a significant drawdown of U.S. inventories and large production cuts in the Gulf of Mexico in the wake of the hurricane. Natural gas prices in European markets reached record levels. These prices peaked after Russia restricted supply amid uncertainty over the launch of the Nord Stream 2 pipeline and low natural gas reserves in EU storage facilities. Except for China's domestic market, steel prices fluctuated within a narrow range as a pullback in demand due to more severe quarantine measures in some countries balanced out the slump in steel production in China. China's production cuts also pushed iron ore prices down. Grain prices fluctuated mildly as crop deliveries met current demand. Appetite for risky assets in global financial markets – EM assets in particular – was dampened by investor concerns about the Chinese real estate market, the Fed's tapering, and the slowdown in global recovery. As a result, most EM currencies weakened against the U.S. dollar.

Inflation

In August 2021, consumer inflation was 10.2% yoy, flat from the previous month. The slowdown in nonfood price growth offset the further rise in prices for services and food products due to higher production costs and sustained consumer demand. However, the increase in raw food prices was constrained by a greater supply of seasonal vegetables and fruits. Specifically, price drops for beets, potatoes, carrots, and sweet peppers deepened as the new harvest came to market. Core inflation inched lower (to 7.2% yoy from 7.3% yoy in July) due to a further slowdown in sunflower oil price growth and the strengthening of the hryvnia. The rise in natural gas prices decelerated due to the fading of the base effect and because of the annual gas contract option for households.

Producer price growth continued to accelerate (to 46.5% yoy),primarily driven by higher prices in the domestic energy sector.

Economic activity

The growth in the IKSO accelerated to 6.4% yoy in August. The record harvest of early grains drove rapid growth in agriculture (25.0% yoy), which also underpinned related sectors (food, trade, transport). Sustained consumer demand contributed to high rates of growth in retail trade (9.6% yoy) and passenger turnover. Robust investment demand helped return construction to growth (by 10% yoy) and supported certain other sectors, including machinery. However, overall industrial growth was marginal (0.6% yoy), as tougher competition on external markets weighed on the performance of the metals-and-mining sector. The reduction in natural gas transit and the waning of the low base effect also prevented economic performance indicators from improving.

Labor market

Wage growth accelerated (to 22.3% yoy in nominal terms and to 10.9% yoy in real terms), spurred by the economic recovery and stronger demand for labor both in Ukraine and abroad.

Fiscal sector

The state budget in August recorded one of the largest monthly surpluses for the period (UAH 43.4 billion), thanks to high revenues. The revenue growth (by 39.2% yoy) was fueled by sustained consumer demand, high prices for natural resources, and better financial performance of businesses. Expenditures returned to growth (up 6% yoy), among other things due to higher spending on social protection and education. Still, the growth in total expenditures remained modest, largely due to the high base effect: spending on road infrastructure was lower than last year, and the increase healthcare spending slowed. Local budgets in August ran a traditional surplus (UAH 9.5 billion).

Balance of payments

The current account moved back into surplus (USD 0.2 billion) in August due to a significant narrowing of the merchandise trade deficit. Specifically, the arrival of the new harvest of wheat and barley amid high prices for these crops propelled grain exports to record levels and total exports of goods to grow by 51.8% yoy. At the same time, the growth in exports was restrained by agricultural exporters, which held back on deliveries in a bid to reap higher gains should global prices rise further. In addition, volumes of metals-and-mining exports declined slightly, partially due to tougher global competition. Growth in merchandise imports sped up (to 40.5% yoy) due to both a further rise in prices and an increase in import volumes of energy, in particular natural gas and oil products. At the same time, the increase in imports of machinery products slowed somewhat on account of fewer cars and selected industrial equipment as a likely result of the global shortage of semiconductors.

The financial account recorded small capital outflows (USD 0.1 billion), generated by the public sector. Nonresidents continued to sell off their hryvnia-denominated government securities as global investor appetite for risky assets waned, reflecting uncertainty around the Fed's tapering. The public sector's capital outflows were partially offset by the private sector's capital inflows. In particular, an increase in FDI, largely due to high reinvested earnings, surpassed the increase in cash outside banks. Despite the marginal overall balance of payments surplus thanks to the SDR allocation, Ukraine's international reserves reached a nine-year high of USD 31.6 billion. This is sufficient to cover 4.4 months of future imports.

Monetary conditions and financial markets

In September, the NBU Board decided to raise its key policy rate by 0.5 pp, to 8.5%, and to roll back its emergency monetary measures, starting in Q4. This will help keep inflation expectations in check and bring inflation back to the target of 5% in 2022. The UONIA – the Ukrainian OverNight Index Average – increased, but it stayed near the lower limit of the NBU's interest rate corridor because of the sustained significant liquidity surplus in the banking system. The primary market yields on hryvnia domestic government debt securities also rose. Interest rates on hryvnia banking products for nonfinancial corporations crept higher in August in response to the monetary policy tightening by the NBU. At the same time, the weighted average rates on household transactions remained virtually unchanged.

The FX market was marked by appreciation pressures throughout September, despite a decrease in hryvnia domestic government debt securities held by nonresidents. The main sellers of foreign currency were agricultural businesses, the metals-and-mining sector, and large state-owned companies. The NBU made USD 115 million of net FX purchases in September (compared to USD 1.4 billion since the year started).

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.