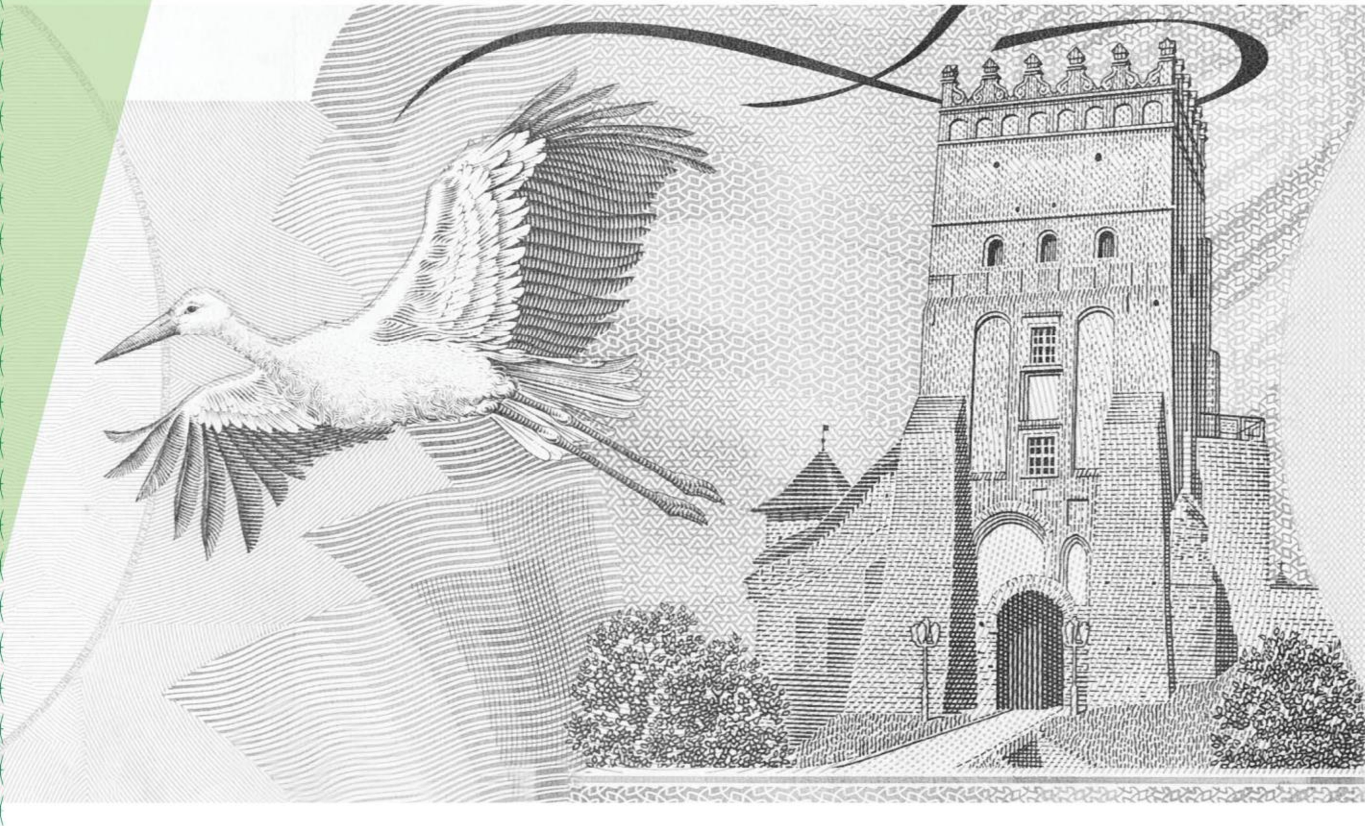
National Bank of Ukraine

Macroeconomic and Monetary Review

September 2019



Summary

In September 2019, Ukrainian exporters faced worsened conditions in global commodity markets. The weakening of external demand drove down steel prices, while the arrival of the new harvest put downward pressure on grain prices. The intensification of geopolitical conflicts led to rising oil and natural gas prices. At the same time, an easing of monetary policy by the world's leading central banks helped restore investor appetite to risky assets, including those in emerging markets. Accordingly, most currencies in the countries of this group have strengthened since the beginning of September.

In August 2019, consumer inflation declined to 8.8% yoy. The slowdown in the growth of administered prices and in core inflation outweighed the acceleration in food price growth. Core inflation thus decreased to 7.2% yoy, thanks to the tight monetary policy, which held back underlying price pressures, including through the exchange rate channel. An additional factor was a significant decrease in fuel prices amid similar trends in international energy markets, which along with the appreciation of the hryvnia resulted, among other things, in producer price inflation decelerating to 4.5% yoy.

In August 2019, the increase in the IKSO slowed (to 1% yoy) as a result of the expected deterioration in the performance of agriculture as the harvesting of early grains was completed earlier this year compared to last year. The decline in industry accelerated, led primarily by a downturn in manufacturing, particularly in the food industry, metallurgy, and engineering. Meanwhile, the growth in construction was supported by rising capital expenditures of the consolidated budget. Retail trade and passenger turnover showed strength amid steadily rising household incomes (in August, nominal and real wages increased by 17.4% yoy and by 7.7% yoy, respectively) and high consumer sentiment. Wholesale trade returned to rapid growth amid an increase in the mining and exports of metal ores, sizable exports of grains, and an increase in coal imports.

In August 2019, the state budget ran a surplus of UAH 5.2 billion, despite a significant deterioration in revenues. Specifically, revenues decreased in annual terms primarily due to differences in the schedules of fund transfers by the NBU and Naftogaz of Ukraine NJSC this year compared to the previous one. In addition, the growth of tax revenues slowed down, affected by a drop in tobacco production, cheaper natural gas, and subdued imports in hryvnia equivalent. Expenditures, especially capital ones, grew more quickly. Local budget surpluses widened significantly (to UAH 7.4 billion). As a result, the consolidated budget surplus rose to UAH 12.6 billion.

In August 2019, the current account continued to run a deficit (USD 0.5 billion) on account of a sustained merchandise trade deficit. Ample grain harvest continued to support the growth in exports of goods, however it decelerated, dragged down by a number of temporary external factors. By contrast, imports grew at a steady rate, primarily driven by machinery imports. Inflows to the financial account amounted to USD 0.6 billion but decreased compared to July amid a temporary weaker nonresident demand for hryvnia domestic government bonds. As a consequence, the balance of payments reported a surplus (USD 0.1 billion), while international reserves increased to USD 22 billion, or 3.5 months of future imports as of late August.

In September 2019, the NBU Board continued the monetary policy easing cycle, cutting the key policy rate again this year (by 50 bp to 16.5%). This decision and the high likelihood of further cuts to the key policy rate, strong demand for hryvnia domestic government bonds, particularly from non-residents, and the government's curtailment of their supply contributed to a decrease in yields on hryvnia domestic government bonds in September for all maturities. The UIIR also declined in September, fluctuating slightly above the lower bound of the NBU's rate corridor. In addition to the transmission mechanism, the decline in the UIIR was driven by the increased liquidity of the banking system. The FX market continued to be dominated by an appreciation trend driven by fundamental factors. This allowed the NBU to continue to replenish international reserves without counteracting market trends.

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.