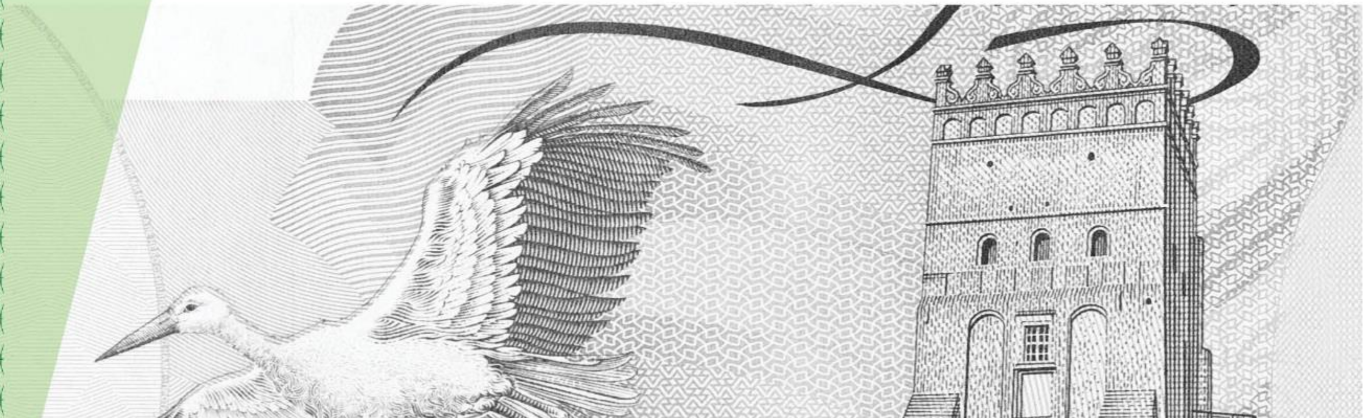
National Bank
of Ukraine

Macroeconomic and Monetary Review

December 2019



Summary

External Environment

Global commodity and financial markets rallied in December on expectations that the U.S. and China would sign the first stage of a trade deal. Global oil prices also rose amid declining U.S. oil reserves and current restrictions under the OPEC+ agreement. The External Commodity Price Index for commodities prevailing in Ukrainian exports grew for the second month running. Prices for steel and hence iron ore increased due to the inventory accumulation ahead of the holiday weekend and because of production limitations. Grain prices, including wheat and corn, increased, driven by rising demand, particularly from New Zealand, Iran, and Egypt, the Argentinean government's announcement of another increase in export tariffs on these grains, and the delay of the corn harvesting period in Brazil over bad weather.

Optimism prevailed in global financial markets as demand for risky assets continued to grow. Apart from expectations of the signing of a U.S.-China trade agreement, the market was buoyed by better-than-expected macroeconomic data out of the U.S., primarily on the growth in household income, and by upbeat sentiment about a more orderly Brexit. This triggered an increase in capital inflows into emerging market assets and the strengthening of most currencies in this country group.

Inflation

Consumer inflation declined sharply in November 2019, to 5.1% yoy (versus 6.5% yoy in October), and reached the medium-term target of 5% declared in 2015. Inflation declined across all major CPI components. The hryvnia's strengthening pushed core inflation down further (to 4.8% from 5.8% yoy in October) and caused a slowdown in price growth for noncore goods. That said, prices for mostly imported noncore goods, in particular fuel, continued to drop in annual terms. The upward pressure on raw food prices subsided considerably as supply expanded. The growth rates of administered prices also declined. Although natural gas prices for households increased month on month in November, in annual terms they remained substantially lower than a year ago.

In November, industrial prices fell by 4.5% yoy. The drop in prices was driven by lower global prices for Ukrainian exports. The stronger hryvnia was another contributor to the decrease in input prices.

Economic Activity

The decline in the IKSO deepened in November 2019 (to 3.5% yoy). The downturn in industry accelerated (to 7.5% yoy) across all sectors due to adverse external price conditions and warm weather. In particular, the decline in metallurgy continued to deepen as the European steel market stagnated, which in turn affected other related sectors, namely the mining and coking industries, as well as machinery production. The fall in the food industry also accelerated, in particular due to the decline in tobacco production and lower yields of sugar beets and apples. In the energy sector, production volumes declined substantially due to warm weather, flagging demand from the manufacturing industry, and increased electricity imports. Among industrial sectors, rapid growth was seen in the chemical industry after a large chemical enterprise was put back into operation. The decline in agriculture deepen expectedly as a result of the faster harvesting of grains and oilseeds in previous months, as well as lower crop yields of some crops (soybeans and sugar beet). In animal breeding, production volumes edged down as well.

Meanwhile, the growth in construction continued to accelerate, in particular due to benign weather and the implementation of alternative energy projects. The growth in retail trade turnover sped up, driven by sustained growth in household incomes (the average wage rose in nominal and real terms by 16.6% yoy and 10.8% yoy, respectively), and by persistently strong consumer confidence. Freight turnover also accelerated amid an increase in gas transit through Ukraine.

Fiscal Sector

In November, the state budget recorded a deficit (UAH 4.6 billion). Revenues were 7.4% lower than a year ago, mainly due to nontax revenues, which reflected the different timing of NJSC Naftogaz of Ukraine's transfer of dividends this year and the year before. By contrast, tax revenues increased slightly (by 1.8% yoy), in part due to the improved financial standing of companies. Expenditure growth continued, albeit at a slower pace (3.4% yoy, down from 12.4% in October), driven by lower expenditures on current transfers, debt servicing expenditures, and capital expenditures. Local budgets also ran a deficit (UAH 1.7 billion) as a consequence of lower revenues, primarily official transfers. As a result, the consolidated budget recorded a deficit of UAH 6.2 billion in November.

Balance of Payments

The current account was nearly balanced in November (with a surplus of USD 57 million) compared to the deficit in October and November of last year. This was primarily facilitated by the expansion of the primary income surplus, which was itself due to a decrease in the amount of dividend repatriation amid the steady growth in money remittances.

The merchandise trade deficit narrowed from October, staying at last year's level. Merchandise exports declined in November by 3.4% yoy. More specifically, significant corn deliveries in the past year and the drawdown in carry-over stocks of wheat, rapeseed, and soybeans after record deliveries in previous months resulted in a material slowdown in exports of food products. The increase in the volumes of deliveries of ferrous metals and iron ores was offset by a further drop in global prices. As a consequence, the fall in the value of their exports accelerated. At the same time, merchandise imports also decreased (by 1.9% yoy). The fall in energy imports accelerated: natural gas purchases declined amid record-high reserves in underground storages, while purchases of petroleum products fell due to the scheduled repairs at Belarus's refineries. The rise in imports of machinery products also slowed as purchases of electrical equipment for alternative energy and fuel elements for domestic NPPs decreased. Meanwhile, steady consumer demand supported the rapid growth in imports of foods and industrial goods.

The financial account inflows were unchanged from the previous month's level (USD 0.5 billion), driven primarily by the private sector. Specifically, FDI inflows increased to USD 0.4 billion. Furthermore, the real sector continued to raise funds through the issuance of Eurobonds, which along with the government's redemption of FX domestic treasury bonds and bills boosted the banking system's assets. The public sector also attracted portfolio investments, albeit in smaller volumes, given their reduced supply. As a consequence, the balance of payments recorded a surplus (USD 0.6 billion), while international reserves increased by late November to USD 21.9 billion, covering 3.4 months of future imports.

Monetary Conditions and Financial Markets

In December, the NBU pressed forward with the monetary policy easing, delivering a deeper cut to the key policy rate (reducing it by 200 bp, to 13.5%). Accordingly, the cost of hryvnia funds continued to fall. In particular, the UIIR followed a steeper trajectory of decline, having fluctuated slightly above the lower bound of the NBU's rate corridor for standing facilities over the course of the year. At the same time, the yields on hryvnia treasury bonds and bills continued to decline across all maturities due to strong demand limited supply. The appetite of nonresident investors for hryvnia government securities is driven by the maintenance of macrofinancial stability and expectations of further key policy rate cuts going forward. Hryvnia rates for bank customers continued to decline as well in November in response to the overall downtrend in the cost of market resources. However, household deposit rates continued to show a weaker response to the decline in other market rates.

In December, the FX market maintained this year's trend for the hryvnia to strengthen amid an excessive FX supply over a long period of time. The main sources of FX earnings in December were traditional export-oriented industries (including the agro-industrial complex, metallurgy, and mining), portfolio investment, and an ample supply of FX cash. Given the significant excess of FX supply over FX demand and the fact that the hryvnia's strengthening is driven by fundamentals rather than speculative factors, the NBU in December decided to increase the planned daily volume of FX purchases to replenish international reserves (from USD 30 million to USD 50 million). The NBU's net FX purchases in December amounted to USD 2.9 billion (and to USD 7.9 billion since the start of the year). On top of that, taking advantage of benign FX market conditions, the NBU raised the e-limits on certain fund transfer transactions.

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.