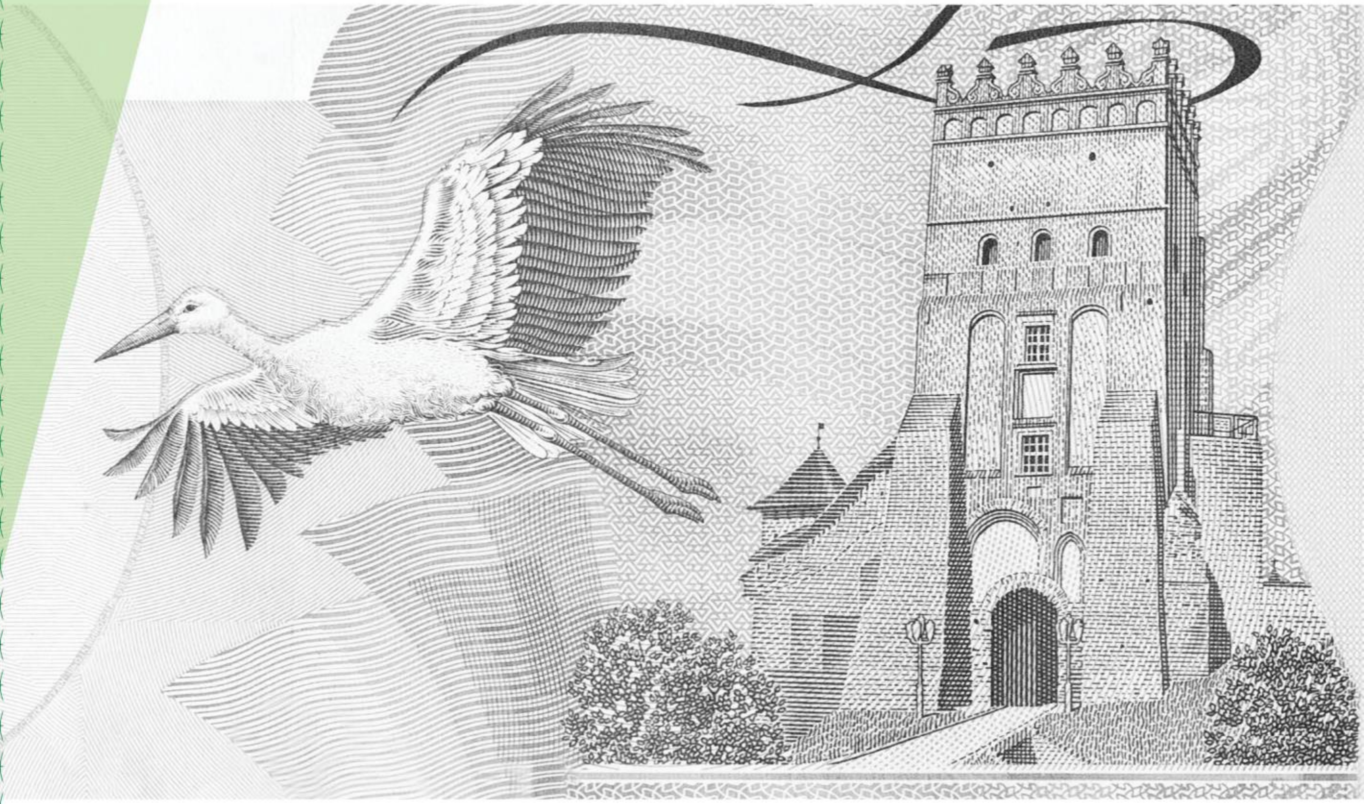
National Bank of Ukraine

Macroeconomic and Monetary Review

January 2019



SUMMARY

In early 2019, the global financial and commodity markets were positively impacted by news on the progress made in trade negotiations between the U.S. and China. Global oil prices rose, in part, due to OPEC+ output cuts and a weather-related reduction in crude oil extraction in Canada. Investors' sentiment towards emerging markets improved, causing most EM currencies to strengthen.

In 2018, consumer price inflation slowed down to the 5-year low of 9.8%, from 13.7% in 2017. The decline in inflation was helped by the NBU's tight monetary policy. In particular, it contributed to the strengthening of the hryvnia against the currencies of Ukraine's main partners in nominal and real terms. Expansion of the domestic supplies of some foods, lower global food prices and a drop in global oil prices towards the end of the year were additional factors of inflation deceleration. Meanwhile, the slowdown in core inflation, to 8.7% yoy in 2018, was moderate, in part, due to the upward pressure on prices from rising production costs.

In December 2018, the IKSO index declined by 2.1% yoy. Most sectors, except retail trade, reported weak results reflecting more severe weather conditions (which particularly weighed on performance indicators in construction and transportation), lagged effects from repairs at metallurgical plants and transportation and logistics problems in the Sea of Azov. Meanwhile, in 2018 as a whole, growth in the IKSO index accelerated to 3.5% yoy, from 2.1% in 2017, driven primarily by the record high harvest of corn and sunflower seeds. Furthermore, solid performance in crop farming propelled growth in wholesale trade, while steady growth in wages, rising at 24.8% and 12.5% yoy in nominal and real terms, supported growth in retail trade.

The December current account deficit stayed at a relatively low level (USD 0.3 billion) compared to previous months, while narrowing compared to December 2017. That largely reflected a marked slowdown in merchandise imports due to lower energy imports and slower growth in machinery imports. Financial account inflows totaled USD 2.2 billion, with the public and private sectors generating almost equal amounts. This left the overall balance of payment balance positive at USD 1.8 billion, which, together with the IMF tranche disbursement, lifted the international reserves to USD 20.8 billion, or 3.4[1] months of future imports.

In December, the state budget showed a significant deficit (UAH 59.1 billion), primarily due to considerable expenditures, as is typical for the end of the year. Meanwhile, revenue growth remained relatively moderate. Local budgets generated a negative balance in both December and for the whole of 2018 (UAH 30.7 billion and UAH 8.5 billion, respectively). As a result, the consolidated budget deficit was also sizable (UAH 89.8 billion in December and UAH 67.8 billion for the 2018 full year).

At its last monetary policy meeting held on 31 January 2019, the NBU Board decided to hold the key policy rate unchanged, at 18% per annum. According to the NBU, the current and forecast monetary conditions are sufficiently tight to bring inflation to its medium-term target of 5% in 2020. Furthermore, in order to show more flexibility in responding to changes in the liquidity stance of the banking system of Ukraine, since 11 January 2019 the NBU launched the new operational framework of the monetary policy.

In December 2018, hryvnia market rates continued to rise, reflecting the previous policy rate hikes and market-specific factors. Yields for hryvnia government bonds kept rising in January 2019, prompting foreign investors' interest towards domestic currency bonds. This, along with FX supply from banks' customers exceeding FX demand, pressured hryvnia to appreciate in January.

The Macroeconomic and Monetary Review is a translation of the original Report in Ukrainian. In case of any discrepancies between the original document and its English translation, readers should consider the Ukrainian version of the Report as correct.

[1] Based on Macroeconomic Forecast approved by the NBU Board on 31 January 2019.