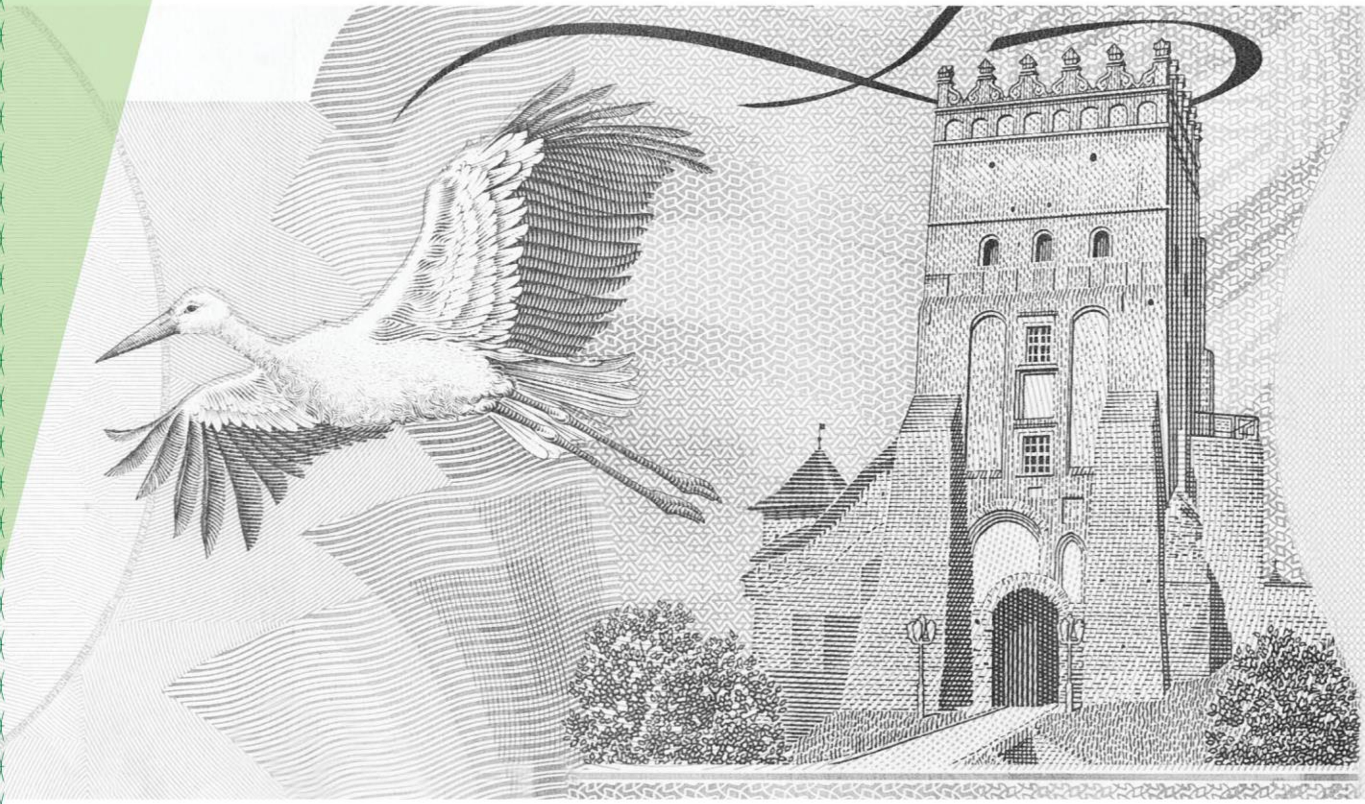
National Bank of Ukraine

Macroeconomic and Monetary Review

February 2019



SUMMARY

Positive news from US-China trade talks continued to dominate world commodity and financial markets in February 2019, improving the global price environment faced by Ukrainian exporters and sending global stock indexes higher.

Consumer price inflation slowed to 9.2% in January 2019 (from 9.8% in December 2018) as fuel prices fell and core inflation declined (to 8.3% yoy). The drop in inflation was driven by the NBU's tight monetary policy, which was reflected in the further strengthening of the hryvnia. At the same time, consumer demand and rising production costs, including the cost of labor, continued to put upward pressure on prices.

Overall, economic activity remained sluggish, with the Index of Key Sectors Output (IKSO) down 0.4% yoy in January. This was primarily due to the continued decline in industrial output on the back of worsened performance in the mining industry and the energy sector. Compared to December 2018, however, most sectors saw their performance improve. In particular, the growth in retail trade accelerated, and the growth in passenger turnover resumed, adding to evidence that consumer demand has continued to expand steadily, fueled by the rapid growth in real wages (9.5% yoy). Construction growth held almost steady, indicating sustained investment activity. The decline in the manufacturing sector slowed, including due to improved performance in metallurgy, the manufacture of machinery, motor vehicles and other transport equipment, and food processing.

The state budget ran a deficit of UAH 11.9 billion, as revenues fell by 1.2% yoy and expenditures spiked by 40.4% yoy. The drop in revenues was partially the result of a temporary factor – sizable VAT refunds (UAH 19.7 billion). Other factors behind the lackluster revenue performance were weak imports, the appreciation of the hryvnia, and a plunge in the manufacture of tobacco products. The sharp expenditure growth was primarily fueled by significant social spending, especially transfers to the Pension Fund. The consolidated budget ran a small deficit of UAH 0.4 billion, as local budgets reported a surplus – a typical outcome early in the year.

The current account recorded a UAH 0.4 billion surplus, as the trade deficit narrowed substantially. The increase in exports of goods accelerated to 9.1% yoy, as exports of foods rose and exports of metallurgical products returned to growth. Meanwhile, imports were nearly flat from last year (up 1.2% yoy), dragged down by lower energy imports and some cooling of domestic demand for imported goods amid calm FX market conditions. Unlike in earlier months, in January Ukraine was a net lender (of USD 0.5 billion) to the rest of the world. In particular, the increase in the net foreign assets of the private sector outweighed the capital inflows into the government sector generated by nonresident investment into hryvnia-denominated securities. The overall balance of payments was close to zero, while international reserves were practically unchanged in late January (USD 20.8 billion) compared to the start of 2019.

At its January meeting on monetary policy issues, the NBU Board decided to leave the key policy rate unchanged at 18.0% per annum. The key policy rate decision determined the cost of market resources. More specifically, the hryvnia domestic government bond yields were little changed in February from a month earlier. Among other factors, the high yields on hryvnia securities contributed to the inflow of foreign portfolio investment. Coupled with higher export revenues, this led to an appreciation trend prevailing in the FX market. The growth in the banking system's liquidity and the lower rates on main refinancing operations (which declined due to a change in the operational design of monetary policy) caused the Ukrainian Index of Interbank Rates (UIIR) to move closer to the lower bound of the NBU's interest rate corridor for standing facilities. The banks' hryvnia rates for their clients continued to rise in January, driven by the lagged effects of the previous key policy rate hikes, amplified by market factors.

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.