National Bank of Ukraine

Macroeconomic and Monetary Review

April 2019

SUMMARY

In April, global prices for commodities prevailing in Ukrainian exports, apart from iron ore, remained virtually unchanged, with market participants adopting a wait-and-see approach amid ongoing trade talks between the U.S. and China. In some commodity markets, prices were supported by a spring pick-up in construction. Meanwhile, prices in some other markets were dampened by the bumper harvests of grains and oilseeds, as well as increased steel output. In turn, iron ore prices were rising on constrained supply from Brazil (due to the January disaster at a dam owned by Vale, the largest iron ore producer) and because of supply disruptions from Australia (poor weather conditions at the end of March adversely affected logistics operations). Global oil prices surged above the $75 per barrel after the U.S. administration decided not to reissue waivers on the U.S. sanctions on Iran granted to some countries that were set to expire at the beginning of May.

Emerging markets benefited from continued favorable conditions in the global financial markets owing to monetary policy easing by the leading central banks, apart from during the last decade of the month. However, positive U.S. economic data amid weak data for the Euro Area helped to strengthen the U.S. dollar. As a result, most emerging market currencies had depreciated by the end of April.

In March 2019, consumer price and core inflation continued to decelerate, to 8.6% yoy and 7.6% yoy, respectively. This can be attributed to a strengthening of the hryvnia against the currencies of Ukraine's main trading partners, which, among other things, was due to a tight monetary policy. In addition, the temporary factors that drove the acceleration in raw food prices in the final days of 2018 and at the start of 2019 have been gradually wearing off. Fuel prices remained lower than last year, thanks to falling global oil prices in previous periods and the strengthening of the hryvnia. The latter, together with lower natural gas prices, contributed to a decline in producer price inflation, to 8.9% yoy.

In January–March, performance across most types of economic activity improved compared to January–February. More specifically, the IKSO index increased by 0.5% yoy, largely due to the index returning to growth in March (by 1.8% yoy). Thus, growth in construction output accelerated, fueled in part by overhauls and reconstruction works at metallurgical enterprises. The agricultural output index slightly accelerated (to 3.4% yoy) on increases in nearly all animal production industries, primarily poultry. The slowdown in industrial production continued to ease, owing to the positive performance of the mining and manufacturing industries in March, in particular, through recovery in metallurgy. In addition, retail turnover continued to accelerate, fueled by robust growth in wages (up by 22.1%% yoy in March), pension benefits (up by 15.1% yoy as of April 1, owing to the rise in military pensions since the start of the year and the planned pension indexation in March), and additional payments to pensioners in March-April resulting from higher-than budgeted proceeds generated from the customs clearance of foreign registered cars.

In March, the state budget deficit widened substantially compared to February (to UAH 12.5 billion). Even so, it remained lower than at the same time a year ago. Budget revenues rose further, at a modest pace (4.5% yoy). In particular, the temporary effect of large proceeds from the customs clearance of foreign-registered cars, subsided as expected. In addition, the pace of growth in revenues was affected by an unfavorable comparison base, reflecting the decision of the Stockholm arbitration court last year. Continued modest import growth amid the strengthening of the hryvnia against the currencies of Ukraine's trading partners weighed on budget revenue growth as well. Meanwhile, expenditures declined in annual terms (by 2.1% yoy). More specifically, expenditures on utility subsidies decreased, among other things, due to a warmer-than-last-year March. Also, payments to the Pension Fund were lower than a year ago due to the statistical effect of significant transfers last year. Local governments also recorded a minor deficit (UAH 1.2 billion), in part due to lower official transfers. As a result, the consolidated budget deficit amounted to UAH 13.7 billion.

The current account deficit widened to USD 0.7 billion in March compared to February, as expected, amid scheduled interest payments on restructured government Eurobonds. However, it remained nearly flat from March last year. At the same time, the goods trade deficit narrowed to USD 0.8 billion. Exports rose at a steady pace (up 7.1% yoy), driven by substantial grain supplies, and exports of some metallurgical products returning to growth.

The growth in imports of goods slowed, to 6.7 % yoy, due to the slowdown in imports of land transport vehicles, as the preferential regime for the customs clearance of foreign-registered cars ended in February. Imports were also depressed by the continued decline in energy imports, on account of both lower prices and physical volumes.

Financial account inflows (USD 1.3 billion) offset the current account deficit. They were generated by the public sector thanks to the loan under the World Bank's guarantee (USD 0.6 billion), co-placement of sovereign Eurobonds (USD 0.4 billion) and investments of non-residents into hryvnia-denominated domestic government bonds (USD 0.3 billion). Net inflows from the private sector were close to zero, due to large repayments by the banking and real sectors. Despite the scheduled loan repayments to the IMF, the overall balance of payments surplus (USD 0.7 billion) contributed to an increase in international reserves to USD 20.6 billion as of the end of March, covering 3.4 months of future imports.

At its April meeting on monetary policy issues, the NBU Board decided to cut the key policy rate by 50 bp to 17.5%, effective from 26 April 2019. According to the NBU Board, inflation declining steadily towards the target of 5% means a cycle of key policy rate cuts can start. However, further policy moves will be contingent on the realization of inflation risks and an improvement in inflation expectations.

The cost of market resources in April was determined by the previous key policy rate decisions, which were to keep the key policy rate unchanged. More specifically, hryvnia domestic government bond yields were little changed in April on the previous month, except for instruments with maturities up to six months, which fell amid strong demand. As in the previous month, the Ukrainian Index of Interbank Rates (UIIR) also exhibited only minor fluctuations, near the lower bound of the NBU's interest rate corridor for standing facilities.

The hryvnia interest rates on deposits and credits for non-financial corporations (NFC) remained almost unchanged in March, while banks' interest rates for households slightly declined. The hryvnia strengthening, the further wage growth and rising pensions, and improved inflation expectations contributed to the continued high inflows of household deposits. Despite the typical decline in the stock of NFC deposits in monthly terms due to quarterly and annual tax payments to the budget, these deposits continued to rise moderately in annual terms.

FX market conditions remained favorable in April. The prevailing FX supply from banks' clients exceeded demand, in part, due to record inflows of foreign portfolio investment in hryvnia bonds. This led to the prevailing appreciation trend in the FX market throughout most of the month – the hryvnia strengthened by 2.3% month-on-month (mom) against the U.S. dollar, and by 3.1% mom against the euro. That said, the National Bank intervened in the FX market in order to build reserves and smooth out excessive fluctuations in the market. Over the month, the positive balance of the NBU's FX market operations amounted to nearly USD 300 million.

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.