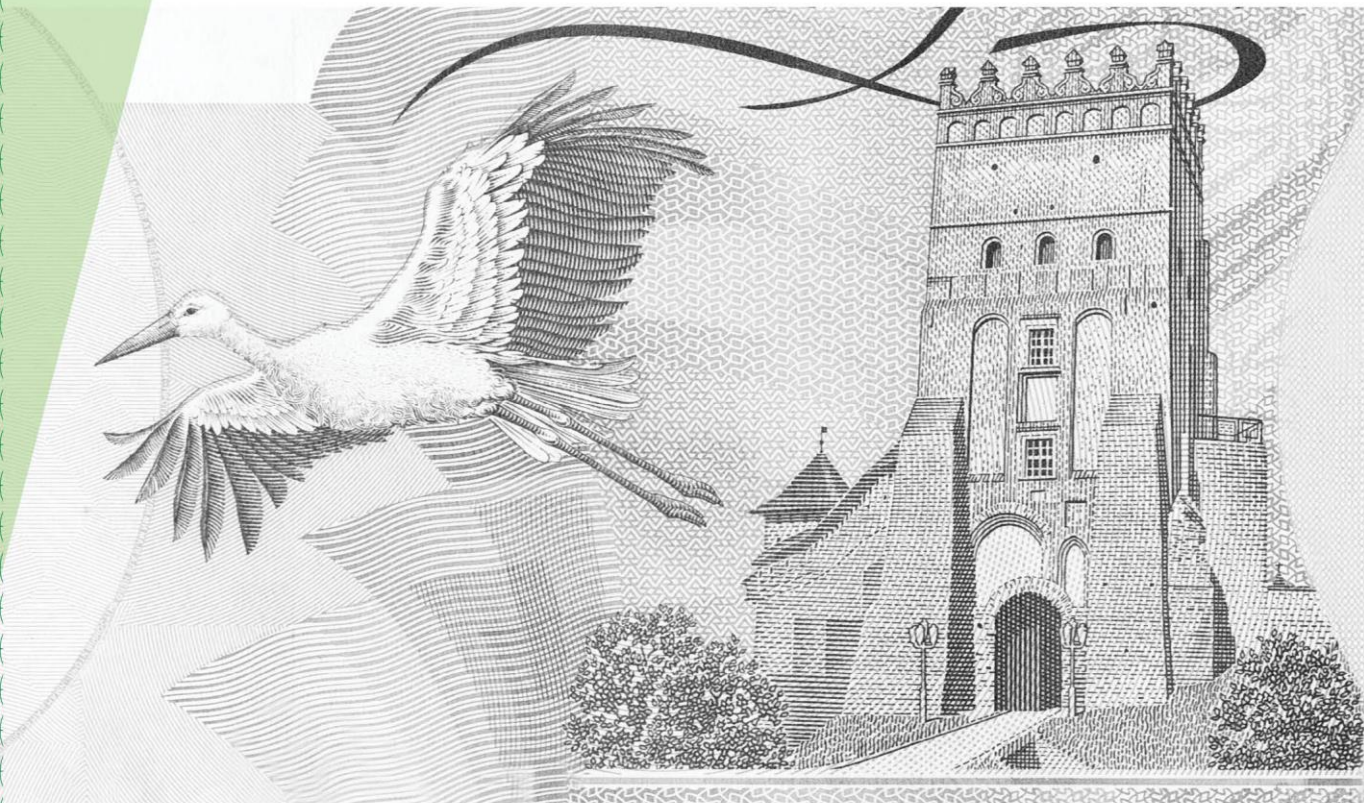




National Bank
of Ukraine

Macroeconomic and Monetary Review

July 2019



SUMMARY

In July, Ukrainian exporters enjoyed an improved global price environment, as measured by the ECPI index, thanks to the growth in prices of iron ore and sunflower oil, which outbalanced the slight reduction in steel and grain prices. Meanwhile, global energy prices showed heightened volatility. After increasing at the beginning of the month amid intensified geopolitical conflicts the prices corrected as the tensions subsided somewhat, demand was sluggish and supply was strong. The global financial markets were relatively calm in anticipation that the world's leading central banks, the Fed and ECB in particular, would ease their monetary policy. The U.S. dollar index strengthened somewhat against a basket of currencies, leaving most emerging market currencies weaker against the U.S. dollar.

In June 2019, consumer price inflation slowed to 9.0% yoy, as the effect of adverse supply factors waned as expected. In particular, the growth in prices for raw foods decelerated sharply after the supply of newly harvested vegetables increased. Core inflation was unchanged at 7.4% yoy. Tight monetary conditions remained a major factor in containing the underlying pressures on prices, including through the exchange rate channel. At the same time, consumer demand and higher production costs kept underlying inflationary pressures high. Producer price inflation hit a five-year low after decelerating materially (to 4.5% yoy), primarily on the back of the decline in global natural gas prices.

In June, the growth in the IKSO decelerated (to 1.9% yoy) despite the substantially faster output growth in agriculture and retail trade. High grain yields and faster harvesting rates considerably sped up the increase in agricultural output. Retail trade turnover grew more rapidly, fueled by the steady increase in household incomes (nominal and real wage growth moderately accelerated in June to 18.1% yoy and 8.1% yoy, respectively) and upbeat consumer sentiment. Meanwhile, economic activity in industry, construction, and transportation deteriorated, partially due to temporary factors.

The current account ran a deficit of USD 0.4 billion in June, primarily as the merchandise trade deficit widened. Exports of goods declined, driven mainly by temporary factors: the depletion of grain and ore reserves, and the ongoing repairs at metal companies. By contrast, imports continued to grow despite having slowed, supported by steady consumer demand. Capital inflows into the financial account (USD 1.6 billion) resumed, which were mainly driven by public sector borrowings. The substantial overall balance of payments surplus lifted the international reserves to USD 20.6 billion in late June, covering 3.3 months of future imports.

The state budget recorded a UAH 8.9 billion deficit in June as projected, due to a slowdown in revenue growth (to 1.1% yoy). The slowdown resulted from lower dividend payouts by a number of state-owned companies, in part due to a decline in net profits in 2018 from a year earlier, high VAT refunds, and the slower growth in imports. The growth in expenditures continued to moderately accelerate, including due to current expenditures on goods and services. Local budgets also moved into deficit, in part because of the seasonal increase in spending on education. As a result, the consolidated budget ran a deficit of UAH 12.8 billion, but the cumulative balance remained positive (UAH 21.1 billion).

In July, the NBU Board extended its monetary policy easing cycle by cutting the key policy rate by 50 bp, to 17%. In addition, the NBU started publishing the key policy rate forecast. Under the baseline scenario, the NBU will take further steps to reduce the key policy rate to 8% in the coming years. The UIIR also declined slightly, hovering at the lower bound of the NBU's rate corridor. Yields on hryvnia-denominated domestic government bonds declined as well. Apart from the key policy rate cut, the yields were influenced by investor expectations that more rate cuts were coming. This increased the demand for government securities, including from nonresidents, and shifted investor focus to medium- and long-term instruments. The hryvnia strengthened in July due to the significant supply of foreign currency, while the NBU replenished international reserves through FX interventions.

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.