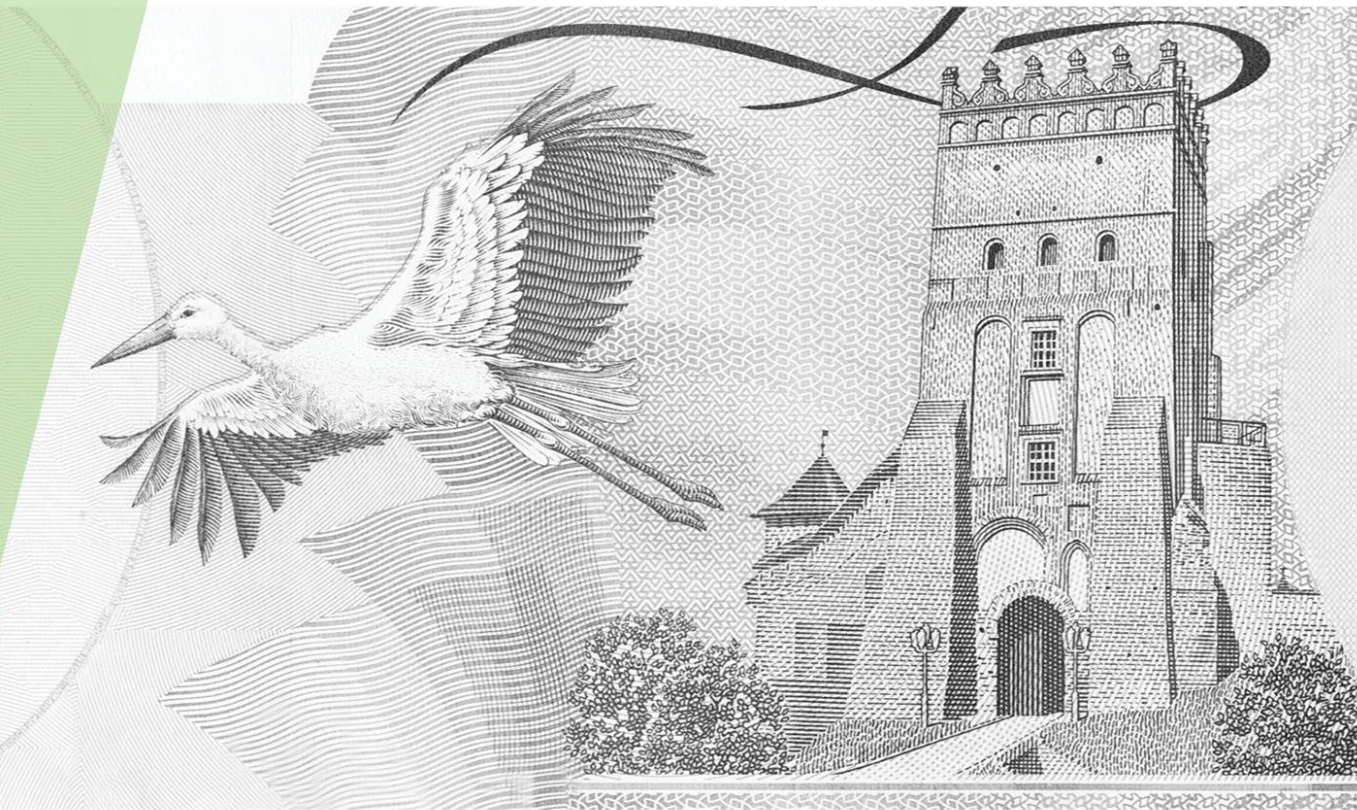




National Bank
of Ukraine

Macroeconomic and Monetary Review

May 2020



Summary

External Environment

In May, the global commodity and financial markets showed upbeat sentiment about the gradual resumption of economic activity after a number of European countries and the U.S. partially relaxed quarantine restrictions. Against the backdrop of a strengthened OPEC+ deal that curtails production, the optimism pushed oil prices higher as Saudi Arabia and Kuwait unveiled potential for further production cuts. Steel prices increased moderately, supported by the economic recovery in China. Higher prices for iron ore due to reduced production in Brazil, which has one of the highest rates of spread of COVID-19, also contributed to the rise in steel prices. In contrast, prices for grains, including wheat and corn, declined as panic demand faded and analysts made optimistic projections for the grain harvest in the marketing year 2020/21.

Investor sentiment in the global financial markets improved, partly thanks to better-than-expected industrial PMI in the eurozone and the U.S., news of preliminary positive results from the clinical trials of one of the coronavirus vaccines, and prospects for setting up an EU fund to fight the pandemic. This whetted the appetite for risk, including EM assets, which stabilized and in some cases strengthened the currencies of this group of countries against the U.S. dollar.

Inflation

In April 2020, consumer inflation slowed to 2.1% yoy (down from 2.3% yoy in March). In monthly terms, prices grew by 0.8%. As expected, consumer inflation remained below the 5% \pm 1 pp target range.

Price growth was restrained by lower prices for energy (both oil and natural gas), declining demand for certain goods and services, and a significant supply of vegetables. In addition, certain services were banned during the quarantine, making their prices unobservable, so these prices remained at the previous month's levels. These factors outweighed the price impacts of the weakening of the hryvnia in March and speculative demand for some goods, which continued into the first half of April. Core inflation remained at 3.1% yoy, the level of the previous month.

The fall in producer prices decelerated in April (to 2.6% yoy) as price pressures from exported products eased and price growth in the supply of electricity and natural gas accelerated on the back of fading comparison-base effects.

Economic Activity

The performance of all sectors of the economy for which monthly data is available deteriorated sharply in April, as the effect of quarantine measures was fully felt. The IKSO fell by 15.4% yoy (compared to 6.3% yoy in March). Although no direct quarantine restrictions were applied to industrial sector, the industrial downturn deepened (to 16.2% yoy). At the same time, the higher incidence of COVID-19 correlated with a more significant decline in industrial production in the region due to both stricter quarantine enforcement and regional differences in industrial structure. Declining investment and consumer demand led to a deepening slump in engineering, worsening external conditions to the one in metallurgy, while subdued demand from most economic activities adversely affected the energy sector.

The spillover effects of quarantine restrictions and low consumer demand on the back of deteriorating consumer sentiment deepened the decline in the manufacture of consumer goods, including food, and led to a sharp decline in retail trade (by 14.9% yoy). For the first time in Ukraine's history, passenger traffic came to an almost complete standstill (with passenger turnover dropping by 95.8% yoy). The performance of wholesale trade and freight turnover worsened as production in core industries fell, imports plunged, and natural gas transit volumes contracted. The drop in construction continued amid limited funding from the state budget and declining demand for housing due to elevated uncertainty.

Labor Market

The labor market situation deteriorated rapidly after the authorities imposed quarantine measures. Wage growth decelerated to 1.6% yoy in April from 11.8% yoy in March. Wage decreases in April were seen in construction, transport, trade, and industry, while wage growth in sectors that are predominantly funded from the state budget slowed sharply. In contrast, the increase in social support for pensioners contributed to a significant rise in pensions. In May, labor supply and demand began to recover amid improved economic expectations as the government lifted some of the quarantine restrictions.

Fiscal Sector

In April 2020, the state budget recorded a significant surplus (UAH 8.5 billion), primarily due to the NBU's transfer of distributable profit for the previous year (UAH 42.7 billion). Yet revenues declined (by 7.3%

yoy), as the drop in economic activity brought about by quarantine restrictions had a negative impact on receipts from practically all major taxes, especially those related to imports. Instead, the growth in the manufacture of tobacco products, and proceeds from corporate income tax supported budget revenues. At the same time, the growth in state budget expenditures accelerated (to 9.4% yoy), driven by the increased support provided to the Pension Fund and higher health care expenditures. Local budgets in April posted a deficit for the second month running (UAH 1.8 billion). As a result, the consolidated budget in April ran a surplus, despite remaining in deficit for the January–April period.

Balance of Payments

In April, the current account showed a significant surplus (USD 1.4 billion), due to a rapid drop in imports of goods and the expenses of Ukrainians on travelling abroad. Combined with a moderate decline in exports of goods and services, this brought the trade in goods balance to a surplus for the first time since 2009, while also widening the surplus in the trade in services. In addition, the expected decline in remittances was offset by a reduction in the repatriation of dividends.

In April, the rate of decline in export of goods remained at the level of March (4% yoy). The spread of the COVID-19 pandemic and the restrictions imposed in connection with it had a divergent impact on the performance of the exports of various commodity groups. The decline in metallurgical exports and corn exports deepened due to lower external demand. Conversely, exports of sunflower seed oil hit a record high on the back of export restrictions imposed by EAEU countries, while the growth in iron ore exports sped up, driven by the economic recovery in China. Merchandise imports declined significantly (by 28.4% yoy), pulled down by a narrowing of domestic demand, restrictions on border crossings, and a further fall in global energy prices. The latter factor, coupled with a slight decrease in the volumes of imports of petroleum products and coal, outweighed the increase in oil and gas imports, deepening the decline in energy imports.

Although persisting into April, the financial account outflow decreased markedly compared to March, to USD 0.7 billion. More specifically, there was a reduction in payments on the Eurobonds issued by the banking sector, and the external liabilities of the government sector. Nonresidents' sales of hryvnia domestic government debt securities remained at the level of March. After the NBU supplied a sufficient amount of foreign currency cash to the FX market, bank customers carried out operations to convert previously purchased cashless foreign currency into cash. This decreased the banks' assets and increased the amount of cash outside the banking system. Capital outflows from the real sector remained at the level of March as there were no repayments on long-term loans. As a result, the current account surplus significantly exceeded financial account outflows, while international reserves rose to USD 25.7 billion, or 4.5 months of future imports.

Monetary Conditions and Financial Markets

In April, the NBU Board accelerated the easing of monetary policy, cutting the key policy rate by 200 bp. In addition, the NBU introduced a set of instruments intended to maintain the liquidity of the banking system by strengthening the resource potential of the banks and improving the transmission mechanism of key policy rate cuts (see Section 2.6. "Monetary Conditions and Financial Markets" in the April 2020 Inflation Report, page 30). The NBU's timely actions contributed to further reducing hryvnia interbank interest rates and the yield on hryvnia domestic government debt securities in the secondary market.

Hryvnia rates for bank customers changed in various ways. The banks reduced interest rates for nonfinancial corporations, reflecting eased monetary conditions and measures to support businesses. Average-weighted rates on deposits were practically unchanged. Coupled with weakening economic activity, uncertainty that was dominating the market when the authorities started to impose quarantine restrictions resulted in a decline in the amount of outstanding loans in April from March. However, the inflow of deposits into the banking system resumed in April, and the volume of hryvnia deposits returned to near pre-crisis levels.

In the FX market, the supply of foreign currency surpassed demand, allowing the NBU to continue to buy foreign currency to replenish international reserves. Overall, the central bank in April generated USD 641 million in net FX purchases.

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.