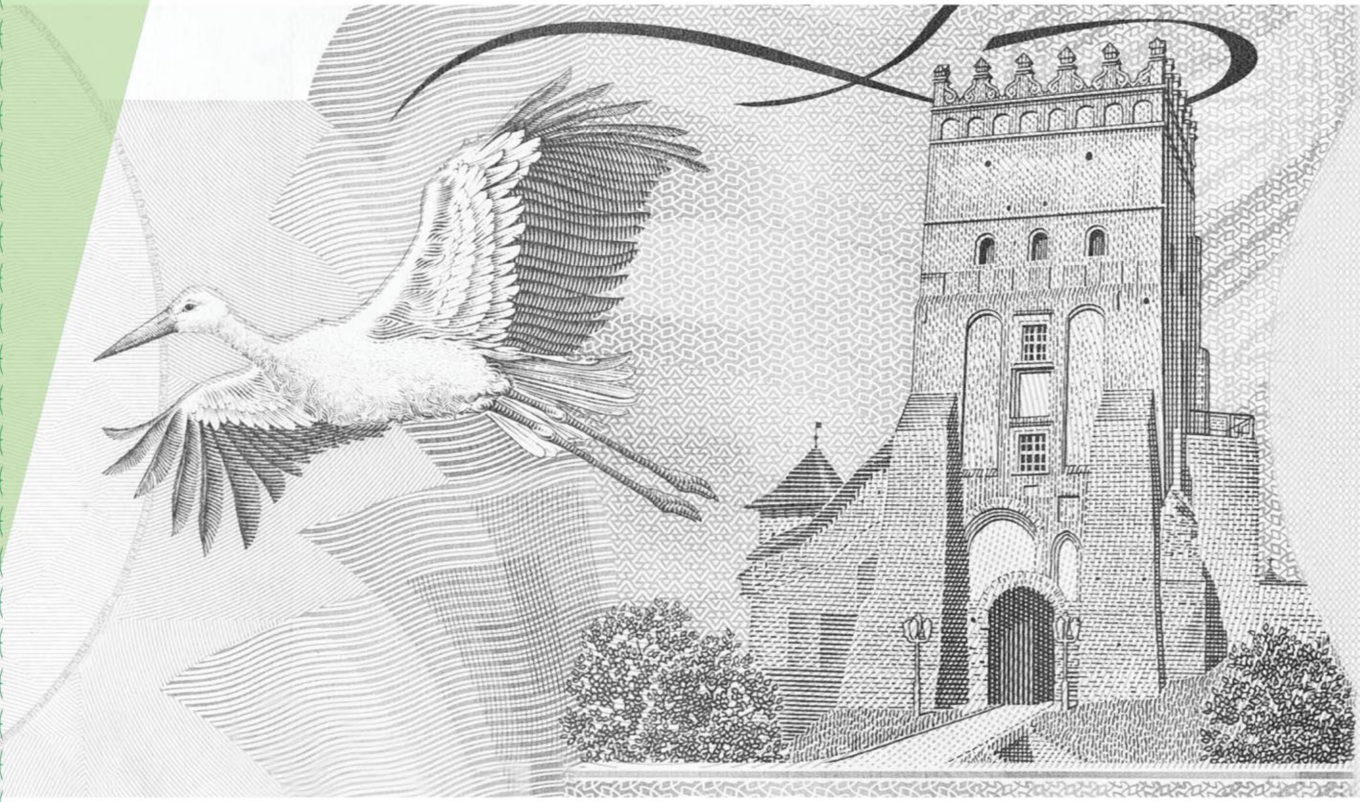
National Bank of Ukraine

Macroeconomic and Monetary Review

September 2020



Summary

External Environment

Conditions in the global commodity markets were better for Ukrainian exporters in September, as demand gradually revived. Additional price pressure came from specific supply factors. In particular, expectations that the current drought would lead to a poor sunflower harvest drove sunflower oil prices sharply higher. Grain prices also rose: the arrival of supplies of newly harvested grains on the market failed to match strong demand from the Middle East and China. Prices for steel and thus iron ore increased as demand picked up gradually not only in China, but also in Europe and Turkey. Oil prices were range-bound, as the effect of the OPEC+ agreement was partially offset by fears that demand would continue to wane amid a new wave of COVID-19. Natural gas prices rose due to an increase in demand ahead of the heating season. With the incidence of COVID-19 rising across the globe, investors shied away from risky assets, particularly those of EM countries. As a result, most EM currencies weakened against the US Dollar.

Inflation

Consumer inflation in August 2020 came in at 2.5% (up from 2.4% in July) in annual terms – below the 5% ± 1 pp target range, as expected. The rise in energy prices, driven by higher global prices, and the reflection of the effects of a weaker hryvnia were largely offset by a slowdown in food price growth. The latter reflected an ample supply of foods, including through higher imports. Core inflation sped up slightly to 3.2% yoy (up from 3.0% yoy in July), thanks to a weaker hryvnia and stronger consumer demand.

The fall in producer prices decelerated in August 2020 (to 4.7% yoy from 7.5% yoy in July), primarily due to the growth in global energy prices, stronger external demand, and higher export prices for certain Ukrainian-made goods.

Economic Activity

August saw a gradual revival in economic activity, with the decline in the IKSO slowing to 1.6% yoy, primarily thanks to trade and construction. Wholesale trade surged amid improved export performance. An increase in exports and shipments of construction materials spurred an improvement in transportation performance. The implementation of public infrastructure projects helped construction return to growth. Higher household incomes, improved consumer sentiment, and a shift to domestic tourism amid sustained restrictions on foreign travel supported retail trade. The slump in agriculture slowed as animal farming improved their performance. In contrast, the downturn in industry deepened amid a decline in energy, still weak investment demand, less benign external conditions for the chemical industry, and a drawdown of sunflower seed stocks, resulting in a fall in the food industry.

Labor Market

Against the backdrop of further recovery in economic activity, wage growth in August accelerated (to 8.6% yoy in nominal terms and 6.0% yoy in real terms). Demand for labor continued to recover, although it remained below prequarantine levels. Interest in job search eased and the number of resumes declined compared to July, likely due to seasonal employment.

Fiscal Sector

In August 2020, the state budget ran a surplus of UAH 10 billion. Revenues grew (by 14.4% yoy) due to a revival of economic activity, an increase in nominal wages, and an improvement in the administration of some taxes. At the same time, the growth in state budget expenditures slowed (to 9.9% yoy) for most items, although expenditures on health care, social protection, and road infrastructure continued to increase at a significant rate. As expected, local budgets recorded a surplus of UAH 6.9 billion. As a result, the consolidated budget ran a significant surplus.

Balance of Payments

The current account went back into surplus (USD 0.4 billion) in August thanks to an improvement in exports of goods (which fell at a sharply lower pace of 2% yoy). Specifically, the expansion of external demand and the catch up in grain supplies drove the resumption of growth in food exports (deliveries of wheat, barley, and rapeseed in August broke historical records for this month). In addition, sustained demand from China contributed to further growth in shipments of ferrous metals. The decline in imports of goods decelerated slightly (to 17.8% yoy) against the backdrop of a gradual recovery in domestic demand. In particular, there were increased purchases of motor cars and freight cars, as well as certain industrial equipment. Meanwhile, imports of machinery products continued to make a significant negative contribution, primarily due to lower imports of alternative energy equipment. Energy imports also continued to decline, as the increase in fuel prices compared to July was offset by lower coal and oil purchases. As a result, the deficit in the trade in goods narrowed significantly. The surplus in the trade in services remained significant, despite there being a further increase in the number of Ukrainians traveling abroad.

The financial account balance was close to zero (USD 19 million): capital inflows to the real sector (including errors and omissions) offset capital outflows from the public and banking sectors. Specifically, capital inflows to the real economy were driven by FDI and loans. In contrast, nonresidents continued to abandon hryvnia domestic government debt securities, though at a moderate pace, generating capital outflows from the public sector. Capital outflows from the banking sector reflected repayments on external liabilities and the exit of a nonresident company from FDI. The overall balance of payments went into surplus (USD 0.4 billion), while international reserves increased to USD 29 billion, which is enough to cover 4.8 months of future imports.

Monetary Conditions and Financial Markets

In September, the NBU Board decided to keep its key policy rate unchanged, at 6% per annum. Monetary policy remained accomodative, with the key policy rate kept below its neutral level in order to ensure that the economy recovers amid moderate inflation and elevated uncertainty over the further spread of the pandemic in Ukraine and the world.

Interest rates in the interbank market continued to correlate with key policy rate movements, while the growth in the banking system’s liquidity kept the UONIA at the lower bound of the NBU’s rate corridor. The growth in the yields on hryvnia domestic government debt securities in the secondary market was due to the global downtrend in investor appetite for risk, an increase in Ukraine’s sovereign risk premium, which foreign investors see as a benchmark, and a worsening of exchange rate expectations. In August, the banks continued to cut hryvnia rates for their customers as interest rates in the interbank lending market trended down. At the same time, funds continued to flow into the banking system.

Increased demand from some groups of importers in September against the background of deteriorating investor risk appetite for EM assets led to an increase in demand for foreign currency. This sent the hryvnia marginally down against the dollar. In those conditions, the NBU in September was a net seller of foreign currency, selling a total of USD 200 million.

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.