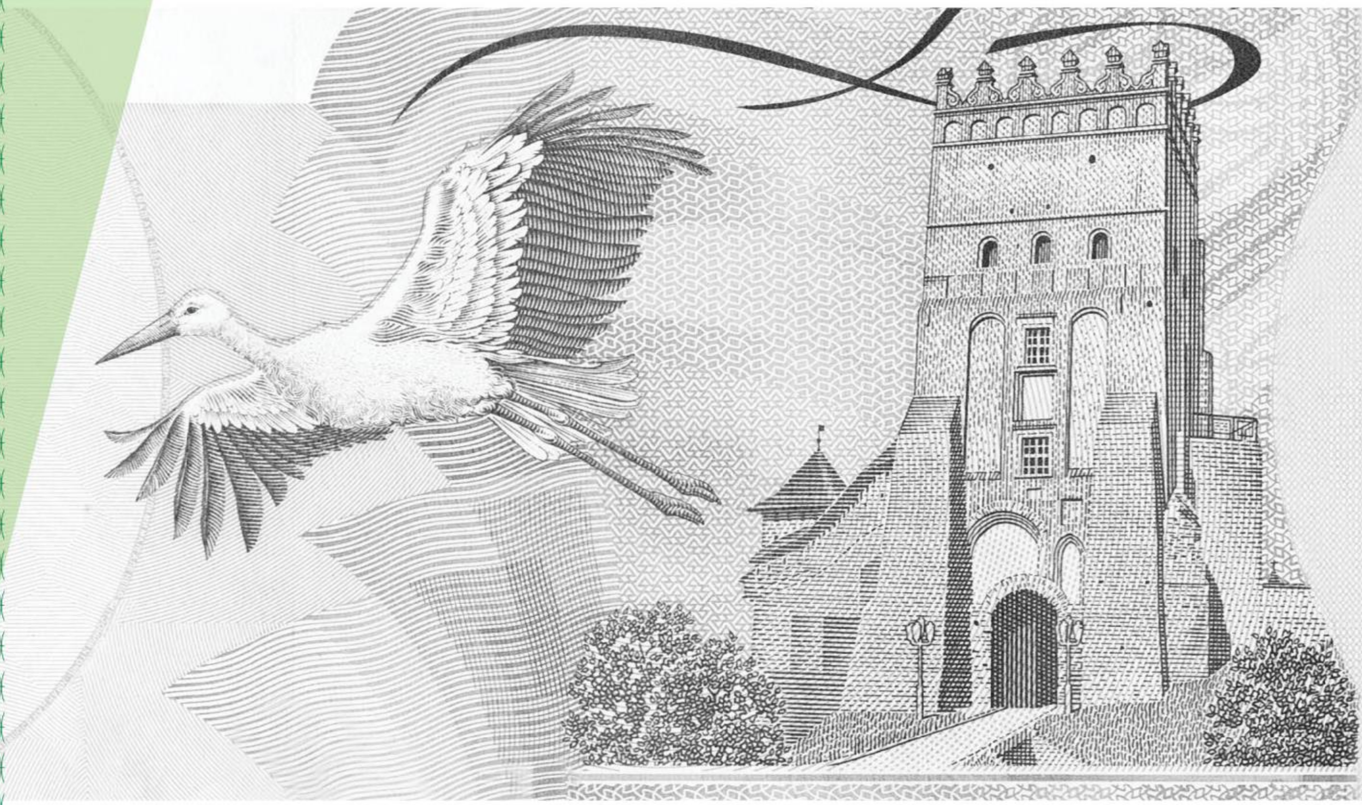
National Bank
of Ukraine

Macroeconomic and Monetary Review

November 2020



Summary

External Environment

In November, conditions in the global commodity and financial markets remained favorable, even as the COVID-19 pandemic worsened around the globe. Against a backdrop of upbeat news about COVID-19 vaccine trials being successful, recovering economic activity supported price growth in the global commodity markets and fueled foreign investor interest in risky assets, including those of EM countries. This resulted in most EM currencies strengthening against the U.S. dollar.

Inflation

As expected, consumer inflation accelerated to 2.6% yoy (up from 2.3% in September), which was in line with the forecast published in the October 2020 Inflation Report. Core inflation also sped up slightly to 3.2% yoy (up from 3.1% yoy in September). Inflationary pressures came from a weaker hryvnia, higher energy prices, and smaller harvests of some crops. Specifically, lower sunflower yields led to a sharp rise in sunflower oil prices. Nonfood prices grew at a faster pace, driven primarily by the weakening of the hryvnia. On the other hand, services rose in price more slowly, in part due to a higher comparison base for certain types of services and the tightening of restrictions in certain areas as the prevalence of disease increased. Inflation was restrained by an increase in the supply of other food products (for some, the supply increase was only temporary) and lower consumption of certain goods (clothing and footwear in particular).

After 11 months of decline, producer prices returned to growth (3.2% yoy) in October. This is mainly attributable to the rise in global prices for Ukrainian exports (ferrous metals, sunflower oil), as well as higher energy prices.

Economic Activity

In October, the drop in the IKSO deepened (to 7.9% yoy from 6.8% yoy in September). The decline in industry accelerated (to 5.0% yoy) amid weak investment demand, a slowdown in the growth of defense budget expenditures, and a weakening of external demand for machinery and chemical products. At the same time, external conditions were favorable for metallurgy, metal ore mining, and vegetable oil and fats production. Weaker demand from the manufacturing industry and warmer weather than last year led to a further decline in the energy sector. Lower yields of major late crops and weak livestock farming performance hampered agriculture and wholesale trade. On the other hand, higher natural gas transit supported freight turnover. Rising wages and expectations for a probable tightening of quarantine restrictions drove growth in the retail trade (to 15.2% yoy) and helped improve passenger transportation performance. Budget expenditures on road infrastructure enhanced a further increase in construction.

Labor Market

In October, wage growth accelerated (to 13.5% yoy in nominal terms and 10.6% yoy in real terms), driven primarily by wage supplements for healthcare workers and further effects from an increase in the minimum wage. In October 2020, labor supply and demand began to decline amid the accelerated spread of COVID-19 and the tightening of quarantine measures.

Fiscal Sector

In October, the state budget ran a significant deficit of UAH 30.4 billion. Public spending continued to grow rapidly (by 33.5% yoy) driven by priority expenditures (health care, social protection, road infrastructure). The growth in other expenditures slowed somewhat. State budget revenues continued to grow (by 9.1% yoy), but at a slightly slower pace. This growth was primarily supported by domestic tax revenues, robust trade growth, an increase in nominal wages, and better administration of some taxes. Local budgets in October were almost balanced. As a result, the consolidated balance of payments ran a significant deficit.

Balance of Payments

In October, the current account moved back into surplus (USD 0.8 billion) due to a significant primary income surplus, which emerged in the absence of repayments on restructured debt, and because of the narrowing trade deficit. The latter was driven by a further decline in imports of goods and services, while exports remained at last year's level. In particular, export shipments of certain metallurgical and mining products, primarily iron ore, increased amid favorable external price conditions and stable demand from China. This offset the decline in food exports due to lower grain and oilseed yields. Imports of goods declined further (to 19.6% yoy), dragged down by drops in imports of some industrial equipment for alternative energy. Energy imports continued to drop at significant rates due to a reduction in gas and coal purchases amid high inventories and because of energy import prices, which were still lower than last year.

The financial account continued to record capital outflows (USD 1.2 billion). Although down from the previous month, they occurred in all sectors. Nonresidents continued their moderate withdrawal from hryvnia domestic government debt securities, generating small capital outflows from the public sector. Capital outflows from the private sector were due to repayments on trade loans and long-term loans, as well as negative reinvested earnings. As a result, the balance of payments recorded a deficit (USD 0.3 billion), while international reserves declined to USD 26.1 billion, covering 4.4 months of future imports.

Monetary Conditions and Financial Markets

In November, rates on hryvnia interbank loans inched up. As the interbank market is segmented and its depth is relatively shallow, this is what typically happens when the banking system's liquidity narrows. Quarterly payments to the budget amid a slowdown in budget expenditure growth, and a further rise in cash in circulation, were the main liquidity-reducing factors in November. Yields on hryvnia domestic government debt securities also increased due to weak demand amid significant government financing needs. Meanwhile, the banks in October continued to lower hryvnia rates for their customers in response to previous cuts to the key policy rate. At the same time, deposit inflows into banks continued. Outstanding hryvnia loans declined as banks moved forward with their efforts to curtail NPLs.

The FX market in November was nearly balanced. As a result, the monthly average hryvnia exchange rate against the dollar was little changed, with the NBU's net FX interventions close to zero.

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.