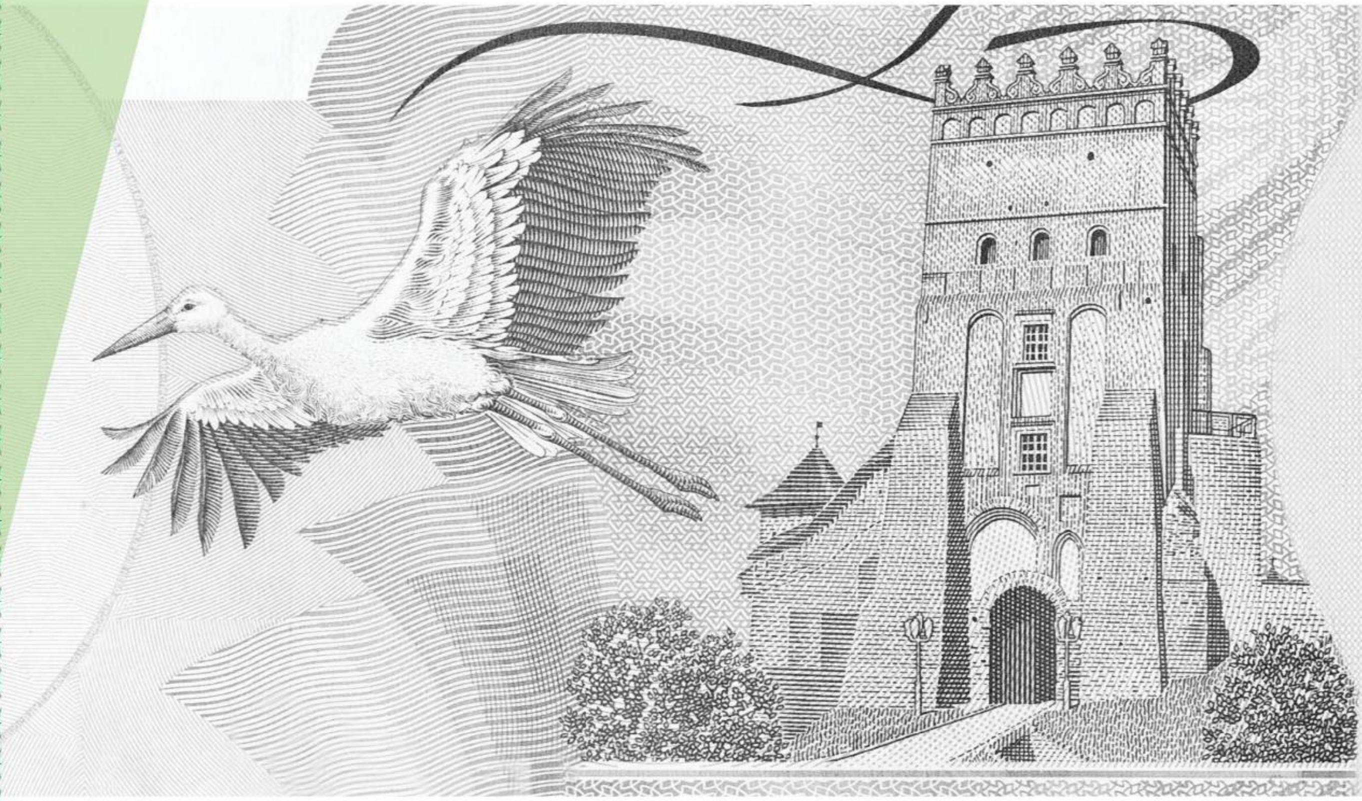
National Bank of Ukraine

Macroeconomic and Monetary Review

December 2020



Summary

External Environment

In December, despite the further spread of COVID-19 and the introduction of lockdown by some countries, external conditions continued to improve as manufacturing activity continued recovering amid optimism associated with the start of vaccination in a number of countries. Global commodity prices, in particular those for oil and natural gas, increased. The growth in natural gas prices was also driven by a significant cold spell that affected the northern hemisphere. A pick-up in manufacturing boosted global demand and thus prices for steel and iron ore amid limited steel inventories and expected lower ore supplies from Brazil. Grain prices remained high due to strong demand, downgraded crop forecasts in Latin America, and the announcement of export restrictions by some countries. In global financial markets, investor appetite for risky assets, including for EMs, increased rapidly as the U.S. elections ended, investors grew more optimistic about fiscal stimulus and the Fed and ECB continued to provide monetary stimulus. As a result, most EM currencies appreciated against the U.S. dollar.

Inflation

In November 2020, consumer inflation accelerated to 3.8% yoy (up from 2.6% yoy in October), approaching the lower bound of the 5% ± 1 pp target range. Core inflation also accelerated to 3.9% yoy (up from 3.2% yoy in October). Rising global prices for oil and lower sunflower yields in Ukraine led to higher prices for sunflower oil and related products (mayonnaise, margarine, spreads). Nonfood products also rose in price due to the weakening of the hryvnia in previous months and strong consumer demand. The growth in administered prices also accelerated significantly as natural gas prices rose amid higher energy prices in global markets. In contrast, footwear pries continued to decline, which can be attributed to changes in households' consumer behavior, as the pattern of working and studying online was used more widely.

Producer prices in November grew at a much faster pace (8.6% yoy). This was primarily due to higher prices for Ukrainian exports (chemicals, metallurgy products, edible oils), as well as rising prices for energy and electricity.

Economic Activity

In November, the IKSO grew (by 3.3% yoy) for the first time since October last year. The decline in industry slowed markedly (to 0.3% yoy) thanks to benign external conditions, favorable base effect for metallurgy (hit hard last year by weak external demand), growth in budget expenditures on defense, and a drop in temperatures compared to last year. Agriculture returned to rapid growth (11.3% yoy) as the harvesting of late grain and industrial crops picked up pace. The increase in exports supported wholesale trade turnover and freight transport. Significant growth in budget expenditures on road infrastructure buoyed the growth in construction. However, with wage growth decelerating somewhat and the "weekend quarantine" coming into effect, the increase in retail trade slowed moderately, while the decline in passenger turnover deepened.

Labor Market

In November, nominal wages grew more slowly (12.2% yoy) amid a tightening of the quarantine (which came to be known as "weekend quarantine") and uncertainty about the imposition of a full lockdown. Real wage growth deceleraded (to 8.1% yoy), weighed down by increased inflationary pressures. Labor supply and demand eased because of seasonal effects and the high prevalence of disease.

Fiscal Sector

In November, the state budget ran a moderate deficit of UAH 7.8 billion. Budget revenues grew at a higher rate (15.3% yoy), fueled by domestic tax receipts due to the growth in trade and wages and better administration of some taxes, as well as by proceeds from imported goods amid a recovery in imports. Meanwhile, the growth in state budget expenditures slowed significantly (to 17% yoy) in almost all areas, including priority ones, although growth rates in the latter remained high. In January–November, the state budget recorded a deficit that was significantly lower than expected for the year, inter alia due to uncertainty over sources of financing. Thus, given significant domestic and external borrowings in December, expenditures are expected to make a major recovery at the end of the year.

Balance of Payments

In November, the current account remained in surplus (USD 0.9 billion) as a slight widening of the goods trade deficit driven by a slower decline in imports was offset by lower dividend payments. Merchandise exports increased (by 8.9% yoy) as the external price environment continued to improve and the harvest of late grain and industrial crops accelerated. This bolstered the growth in the value of exports of grains, edible oils, and iron ore, offsetting the reduction in export volumes of ferrous metals. At the same time, the fall in imports slowed significantly (to 5.4% yoy) due to a further recovery in domestic demand. Specifically, purchases of some types of energy equipment, household appliances, medical equipment, and pharmaceuticals increased. The decline in energy imports decelerated as both natural gas prices and purchases of petroleum products rose.

The financial account recorded further capital outflows (USD 0.9 billion), which were primarily driven by the private sector. More specifically, some banks carried out an early redemption of Eurobonds, while negative reinvested earnings led to marginal FDI outflows. Public sector capital outflows reflected a further moderate decline in hryvnia government debt securities held by nonresidents. With the consolidated balance of payments close to zero, international reserves were little changed, coming in at USD 26.1 billion in late November, enough to cover 4.3 months of future imports.

Monetary Conditions and Financial Markets

In December, the NBU Board left its key policy rate unchanged, at 6% per annum. The key argument, underpinning this decision, was increasing inflationary pressures amid elevated uncertainty about the quarantine and the spread of disease. Keeping the key rate unchanged did not alter the accommodative stance of monetary policy that was needed for further economic recovery, and will ensure that inflation remains moderate.

For most of December, the UONIA moved in a narrow range at the bottom of the NBU's interest rate corridor. With the government's fiscal needs being significant, the yields on hryvnia domestic government debt securities extended their rise. As demand from foreign investors for hryvnia domestic government securities recovered and demand from domestic investors increased, the issuances of these securities reached all-time highs. Banks continued to gradually lower hryvnia rates on most lending and deposit transactions in November in response to previous cuts to the key policy rate. At the same time, hryvnia deposits continued to grow at a high pace. Banks continued their efforts to tackle NPLs on their balance sheets, which was reflected in lower gross outstanding loans.

In the FX market, the FX supply surpassed demand, enabling the NBU to continue to make FX purchases to replenish international reserves. Overall in December, the central bank generated USD 0.3 billion 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.