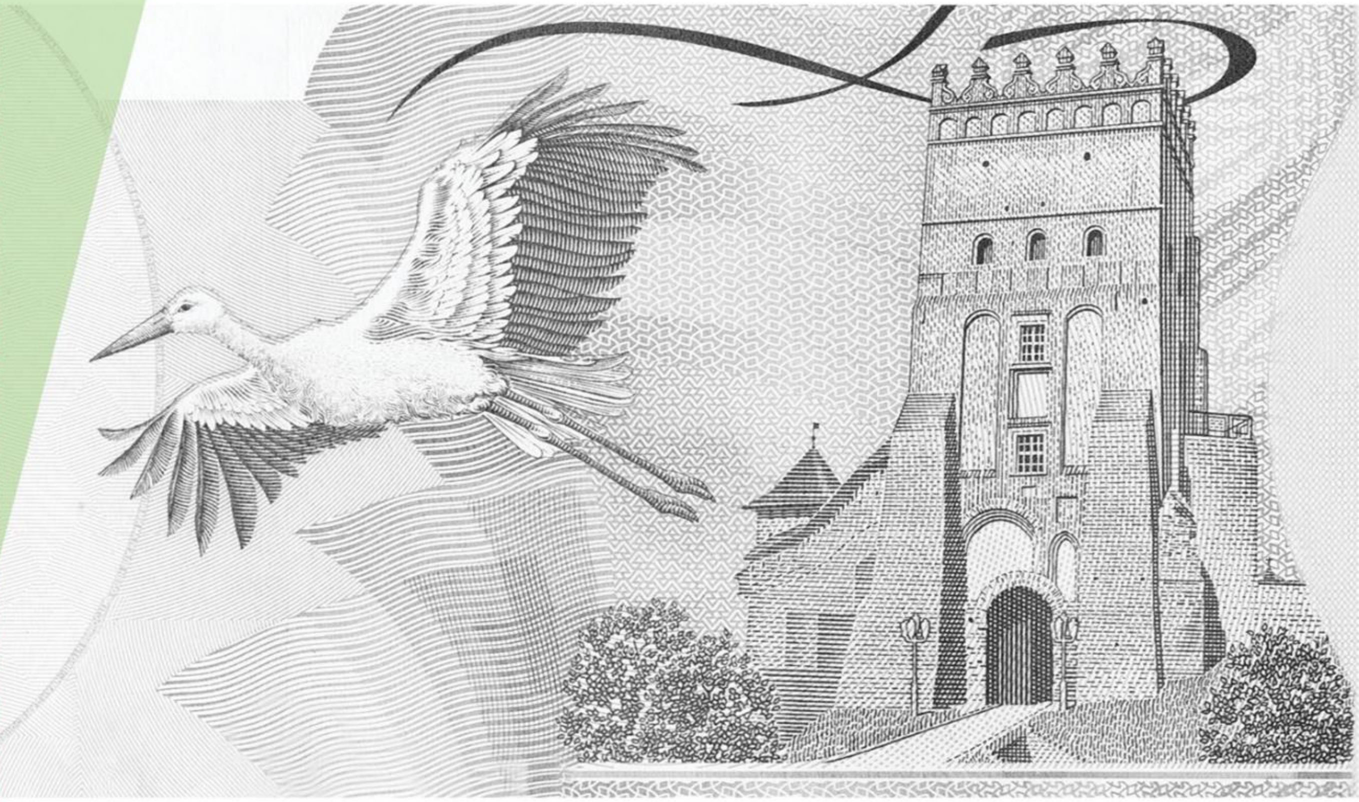
National Bank of Ukraine

Macroeconomic and Monetary Review

January 2022



Summary

External environment

The global economy continued to recover in January 2022 despite the spread of new variants of COVID-19 and economic slowdowns in some countries. Due to the further growth in crude oil demand amid escalating tensions in the Middle East, oil prices reached a 7-year high. In contrast, natural gas prices in the EU market showed signs of stabilization: LNG shipments (primarily from the United States) continued to increase despite low stocks and supplies from Russia. Steel and iron ore rose in price concurrently due to positive expectations of stronger demand in China after it announced government incentives. Upgraded USDA estimates of the world wheat harvest and Algeria's refusal to buy it from France because of political differences (which freed up additional export volumes) compensated for the adverse effects of low global stocks. As a result, wheat prices fluctuated within relatively narrow limits. In contrast, despite the significant global harvest of corn, its prices rose due to worsened weather conditions in Latin America, which may have an adverse impact on crop yields. In the global financial markets, appetite for risky assets, including those of the EMs, ebbed due to expectations of a faster tightening of the Fed's monetary policy. Amid the U.S. dollar strengthening against a basket of leading currencies, this led to the depreciation of most EM currencies.

Inflation

In December 2021, consumer inflation continued to slow to 10.0% yoy. This was facilitated by the expanded supply of fruits and vegetables and lower global crude oil prices. The pace of growth in administered prices remained unchanged from November. Specifically, a further slowdown in utility price growth due to the base effects amid fixed prices for households balanced out the rise in the prices of railway tickets. At the same time, core inflation accelerated (to 7.9% yoy). The main reason was the more pronounced impact of secondround effects from higher energy prices and other production costs, including wages. These effects affected the prices of a wide range of goods and services. The weakening of the hryvnia at the end of the year had an additional impact on price dynamics.

Producer price inflation continued to accelerate (to 62.2% yoy). This was due to increased heat energy prices and higher prices in gas-intensive sectors (chemicals, rubber, and plastics). The PPI growth was restrained by the fall in iron ore prices on an annual basis and the slowdown of price growth in the production of steel and in the manufacture of sugar and sunflower oil.

Economic activity

The IKSO fell by 0.7% yoy in December 2021 (having risen by 13.7% yoy in November). The main contribution to the decline came from agriculture (down 31.8% yoy) due to the faster completion of harvesting and the further decline in livestock farming compared to the previous year. The deficit of and the rise in prices for energy, the high cost of raw materials, and weak external demand for metal ores led to a downturn in industry (by 1% yoy). In particular, the manufacturing of chemical, rubber, and plastic products decreased due to high natural gas prices. The decline in energy deepened because of a shortage of coal. On the other hand, the processing of record harvests fed into production increases in the food industry. A significant increase in capital expenditures and capacity modernization by some companies contributed to the rapid growth of construction (by 21.5% yoy) and supported the machinery sector.

Active exports of agricultural products and transportation of construction materials improved freight turnover. Meanwhile, the decline in wholesale trade resumed due to reduced iron ore exports and coal shortages in Ukraine. Sustained growth in wages and other incomes underpinned retail trade and passenger turnover.

Labor market

At the end of the year, labor supply and demand weakened seasonally. However, demand for Ukrainian workers abroad increased, in particular in Poland due to the easing of requirements for foreigners, especially those having a work permit. Wage growth accelerated rapidly (to 23.1% yoy in nominal terms and to 11.9% yoy in real terms) in both the public and private sectors due to the minimum wage raise (to UAH 6,500, effective 1 December 2021), an increase in the salary scale for public sector employees, and good financial performance of enterprises against the backdrop of record crop yields and high prices in foreign markets. Pensions also rose due to the increase in the subsistence wage.

Fiscal sector

The state budget ran a significant deficit of UAH 131.9 billion in December after a significant pick-up in expenditures for almost all budget items, as is typical for this time of the year. Expenditures on public order, road infrastructure, social protection, and interbudgetary transfers rose substantially. At the same time, budget revenues were also high due to strong domestic demand, accelerating wage growth, and significant imports. On the other hand, the growth in both revenues and expenditures (5.5% yoy and 18.3% yoy, respectively) slowed due to the base effect: in December 2020, Naftogaz NJSC, Ukrnafta PJSC, and the government made significant amounts of mutual settlements. The general government deficit for the year (UAH 197.8 billion) was lower than last year's level and the planned amount. Local budgets also ran a significant deficit (UAH 42.1 billion) in December, but maintained a surplus (UAH 11 billion) for the year.

Balance of payments

The current account deficit in December (USD 0.5 billion) was close to the previous month's level. The expansion of the services trade surplus, caused by the traditionally lower foreign travel expenses in December, offset the increase in the merchandise trade deficit. The latter was caused, among other things, by the sharp rise in prices for energy and hence chemical products, which drove an increase in imports compared to November. In addition, the still weak external demand for iron ore restrained the increase in exports. In annual terms, the growth in exports (41.7%) was driven by larger supplies of, and high prices for, metallurgical products and corn. Sustained domestic demand remained the main driver of import growth (37.3% yoy). In their turn, record amounts of dividend repatriation were offset by the formation of negative reinvested earnings.

The financial account continued to record capital inflows (USD 0.9 billion). In particular, Ukraine received a loan from the World Bank. In the private sector, the drop in banks' external assets due to the purchase of FX domestic government debt securities exceeded the repayment of real sector liabilities. The resulting overall balance of payments surplus (USD 0.4 billion) made it possible to increase international reserves to USD 30.9 billion, which covers 3.8 months of future imports.

Monetary conditions and financial markets

In January, the NBU raised its key policy rate by 1.0 pp, to 10.0%. The materialization of a significant number of pro-inflation risks required the NBU to tighten its monetary policy stance to improve inflation expectations and ensure a sustained decline in inflation. UONIA also increased, hovering close to the lower limit within the NBU's interest rate corridor, as the banking system retained a significant amount of liquidity.

In December, interest rates on bank customer transactions changed in mixed ways. Interest rates on loans to nonfinancial corporations and retail term deposits rose in a gradual response to previous key policy rate hikes by the NBU. On the other hand, the weighted average interest rates on loans to households declined, in particular due to promotional offers by some large banks and because of the active use of the grace period by households during sales and holidays.

A deterioration in the information environment amid geopolitical tensions adversely affected market expectations, eroding the demand for and increasing the yields on Ukrainian assets in domestic and foreign markets. The government therefore raised only an insignificant amount of funds in the primary market through the issue of domestic government debt securities in January. As a result of these factors and significant budget expenditures at the turn of the year, the hryvnia came under depreciation pressure. At the same time, with the information background having improved, the first signs of stabilization of market conditions emerged in late January. This was reflected in the reduction of the risk premium and the strengthening of the hryvnia. In order to smooth out excessive exchange rate fluctuations, the NBU in January conducted FX interventions, primarily to sell foreign currency. Thus, the NBU was a net seller of USD 1.3 billion in January. The hryvnia has depreciated by 4.3% against the dollar since the year started.

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.