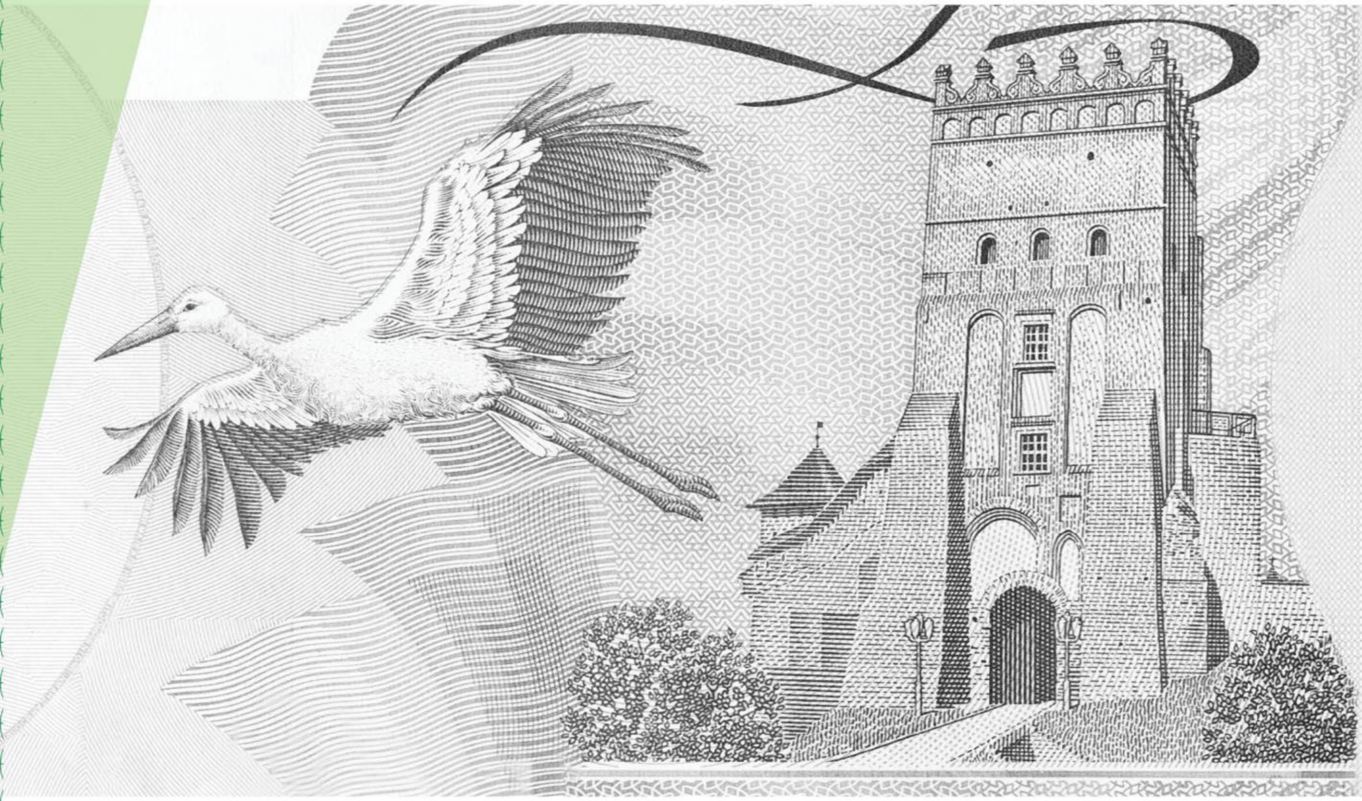
National Bank
of Ukraine

Macroeconomic and Monetary Review

March 2019



SUMMARY

In March 2019, the global commodity and financial markets came under pressure due to Brexit uncertainty and the US president's announcement that trade negotiations with China were taking longer than expected, and that tariffs on Chinese imports might be kept in place even after a trade deal is reached. Meanwhile, the Fed's dovish signals and better-than-expected corporate reports from US companies supported stock indexes. Ukrainian exporters faced a worsened price environment due to lower grain prices and a downward adjustment in iron ore prices following the steep rise seen in the previous months.

In February 2019, headline and core inflation decelerated to 8.8% yoy and 7.8% yoy respectively, despite there being faster growth in food prices – primarily driven by temporary factors. The slowdown in inflation was primarily due to the strengthening of the hryvnia, including due to a tight monetary policy. This affected the prices of imported goods and goods with a significant import share in their production costs. This factor, along with the decline in most commodity prices on the international markets, was one of the main contributors to the slower producer price inflation.

In January–February 2019, overall economic activity remained weak – the Index of Key Sectors Output (IKSO) decreased by 0.5% yoy, primarily due to a drop in industrial output. However, compared to January 2019, the indexes in February improved across almost all types of activity, except for the wholesale trade and energy. In particular, the growth of retail trade and passenger turnover accelerated, indicating a steady increase in consumer demand. The latter was supported by high growth rates of wages (In February were up 20.4% yoy and 10.7% yoy in nominal and real terms, respectively).

In February, the current account recorded a deficit (USD 381 million) on the back of an acceleration of the growth of imports, mainly due to temporary factors. The growth of exports of goods stayed almost flat, due to further growth in the supply of food products. The private sector generated small inflows to the financial account (USD 131 million). Thus, the overall balance of payments showed USD 248 million deficit. Together with repayments of IMF loans, this led to a slight decline in international reserves to USD 20.2 billion, or 3.3 months of future imports.

The state budget deficit narrowed substantially (to UAH 1.8 billion) due to improved revenues and a slowdown in the growth of expenditures. Revenues grew (by 24.8% yoy) both due to increased collection of domestic taxes, and a rise in proceeds from imported goods amid accelerated growth in imports. However, a significant contribution to the revenue growth was also made by temporary factors, in particular the customs clearance of foreign-registered cars. Expenditure growth slowed (to 9.6% yoy), partly due to a leveling of the comparison base on transfers to the Pension Fund. Due to a lower state budget deficit and the typical surplus of local budgets, the consolidated budget returned to surplus (UAH 5.1 billion).

At its March meeting on monetary policy issues, the NBU Board decided to leave the key policy rate unchanged at 18.0% per annum. The key policy rate decision in turn determined the cost of market resources. More specifically, hryvnia domestic government bond yields were little changed in March from the previous month. The Ukrainian Index of Interbank Rates also remained unchanged, fluctuating at the lower bound of the NBU's interest rate corridor for standing facilities. The cost of hryvnia loans has decreased in response to a decline in interbank interest rates in February and weaker demand for loans due to low business activity at the beginning of the year. The yields on HH hryvnia deposits have also fallen.

FX market conditions remained favorable in March amid stronger foreign portfolio investment inflows and the increased FX supply from bank customers in the first half of the month. The latter factor was related among other things to the completion of annual tax payments to the state budget. At the same time, in the second half of March, FX demand increased, reflecting situational purchases from specific market participants.

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